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THE LUXURY CONSOLIDATION JUNGLE: LARGE GROUP AFFILIATED BRANDS VERSUS INDEPENDENT PLAYERS (KINGS OF THE JUNGLE VS CODE BREAKERS)

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The luxury consolidation jungle: group affiliated brands versus independent players

Abstract

The topic of this dissertation is the evaluation of how strategic choices affect the performance of two strategic groups in the luxury industry: companies owned by conglomerates (group affiliated brands) and independent players.

The first chapter presents a summary of the economic literature on strategic group theory. There is still a debate in the literature on how strategic groups should be identified, mainly due to the high sensitivity of the strategic group analysis to the variables adopted. All scholars agree that an in depth knowledge of the industry is necessary to adequately specify the set of variables that should accurately reflect firms' strategic choices and help identify strategic groups.

In the second section I analyze the luxury industry landscape by investigating the main characteristics and major trends over the recent years (vertical integration, consolidation, diversification and war for talents).

The third chapter presents the literature on the theory of industry consolidation and focuses on the current position of the luxury industry in the consolidation curve. The luxury market is highly concentrated, with a few dominant companies coexisting with many small independent players, that end up being acquired by the large conglomerates.

In the fourth and conclusive section, I analyze the main strategies pursued by the two different types of strategic groups (companies owned by large conglomerates and independent players), adopting the conceptual framework of Porter's value chain, taking into account both primaries and support activities. The rational for this choice is that it is not possible to compare the policies of the two strategic groups without analyzing the entire value chain, including support functions that are usually consolidated in large groups.

The study concludes that the main competitive advantage that group affiliated brands have respect to independent players are synergies that conglomerate generate, by pooling different kind of resources (financial, HR, technology, market power, etc..). Three cases studies have been analyzed, Gucci, Bottega Veneta and Fendi, showing that after the acquisition sales, the distribution network and employees improved markedly.

Introduction

The topic of this dissertation is the evaluation of how strategic choices affect the performance of two strategic groups in the luxury industry: companies owned by conglomerates and independent players.

In the first chapter I present a review of the economic literature on strategic group theory, a level of analysis that is in the middle between the industry level and the firm's level analysis. The concept of "strategic groups" was introduced for the first time by Hunt in order to give an explanation to the variance within the same industry of performance of groups of firms, pursuing similar competitive strategies. This theory offers a convenient taxonomy to compare and analyze the different strategies of clusters of firms. There is still a debate in the literature on how strategic groups should be identified, mainly due to the high sensitivity of the strategic group analysis to the variables adopted to group firms. All scholars agree that an in depth knowledge of the industry is necessary to adequately specify the set of variables that should accurately reflect firms' strategic choices and help identify strategic groups.

In the second section of the dissertation I analyze the luxury industry landscape by investigating the peculiarities of this industry and its major trends over the recent years (vertical integration, consolidation, diversification and war for talents). I provide a bird's eye view of the luxury sector and a description of its main players, the "big four" conglomerates (LVMH, Kering, Richemont, Swatch) that have acquired over the last years many independent luxury companies such as Bulgari, Gucci, Bottega Veneta, Fendi.

The third chapter presents theoretical models that try to explain the pattern of industry consolidation, focusing in particular on the Merger Endgame model. This model can be described as a firm's race for market dominance, an endgame, toward an endpoint that is the final stage of consolidation process. Most industries follow a predictable consolidation life cycle based on four different stages: (i) opening, (ii) scale, (iii) focus and (iv) balance and alliance. The long-term success of a company is strictly linked to the way it progresses through the stages of industry consolidation. For this reason, it is vital for a firm to understand at which point in the cycle their industry is. In the consolidation curve, the luxury sector should be positioned between the end of scale stage and the last two stages of the consolidation curve.

The fourth chapter represents the core of the dissertation. It focuses on the strategic choices made by luxury companies belonging to two clusters of firms: group affiliated brands and independent players. To identify the strategic dimensions characterizing the conduct of luxury companies, I adopt the conceptual framework of Porter's value chain, taking into account not only primary activities but also support activities. The rational for this choice is that it is not possible to compare the policies of the two strategic groups without analyzing the entire value chain, including support functions, which are usually consolidated in large groups.

The study concludes that the main competitive advantage that group affiliated brands have respect to independent players are synergies that conglomerate generate, by pooling different kind of resources (financial, HR, technology, market power, etc..). Three cases studies have been analyzed - Gucci, Bottega Veneta and Fendi - showing that after the acquisition sales, the distribution network and employees improved markedly.

1. The strategic groups theory: a review of the literature

1.1 Developments of the strategic groups theory.

Until the early seventies Industry Organization (IO) economics was dominated by the structure-conduct-performance paradigm (SCP), according to which industry structure (supply concentration, demand concentration, product differentiation, market entrance barriers) affects managerial strategic choices, which in turn are responsible for firms' performance and, in particular, profitability. The SCP paradigm, which was first proposed by Mason (1939)[1] and subsequently developed, in particular, by Bain (1959),[2] two economists associated with the Harvard Business School, is considered a pillar of the industrial organization theory. As stated by P. Ghemawat "*Bain's insights led to the rapid growth of a new subfield of economics, known as industrial organization, or IO for short, that explored the structural reasons why some industries were more profitable than others*"[3].

According to the SCP paradigm, there is an optimal strategy that firms belonging to a specific industry ought to pursue and differences among outcomes are only due to the way the strategy is implemented. This is in contrast with the ideas prevailing in strategic management, which stresses instead the relevance of individual firm's choices as the main driver of performance and profitability.

However, in 1972 Hunt observed the coexistence in the same industry of cluster of firms pursuing different strategies[4]. Noting the asymmetric strategies pursued by strategic groups of firms operating in the U.S. white goods industry, Hunts (1972) challenged the IO perspective proving the inability of SCP theory to explain large differences in companies' performance within a single industry[5].

In his doctoral dissertation Hunt introduced the notion of "strategic groups" in order to give an explanation of the variance in performance between groups of firms within the "white goods" industry in the 1960s. In its work Hunt suggested to classify competitors within the same sector in clusters/groups of firms pursuing similar competitive strategies in a rather heterogeneous industry environment[6].

Hunt coined the term "strategic group" to describe "*a group of firms within the industry that are highly symmetric with respect to cost structure, the degree of vertical integration, and the degree of product differentiation, formal organization, control systems, management rewards/punishments, and the personal views and preferences for various possible outcomes*" (Hunt, 1972).

According to Gee and Thomas "*these groups are called strategic groups because of the criteria by which they are observed. They are essentially long term in nature and costly to reverse*"[7].

The most commonly used definition of strategic groups has been provided by Porter in 1980: "*a strategic group is the group of firms in an industry following the same or a similar strategy along the strategic*

[1] Mason E., 1939, Price and Production Policies of Large Scale Enterprise. American Economic Review (March), 61-74.
[2] Bain J.S., 1959, Industrial Organization (first edition), John Wiley.
[3] Ghemawat P., 2002, Competition and business strategy in the historical perspective, Business History Review 76 (Spring).
[4] Hunt M.S., Competition in the major home appliance industry 1960-1970, unpublished doctoral dissertation, Harvard University, 1972.
[5] Ghemawat P., 2002, Competition and business strategy in the historical perspective, Business History Review 76 (Spring).
[6] McGee J., Thomas H., 1986, Strategic Groups: theory, research &taxonomy, Strategic Management Journal, March 1986.
[7] McGee T., Thomas H., Strategic Groups: theory, research & taxonomy, Strategic Management Journal, March 1986.

dimensions. An industry could have only one strategic group if all the firms followed essentially the same strategy. At another extreme, each firm could be a different strategic group. However, there are usually a small number of strategic groups, summarizing the essential strategic differences among firms in an industry[8].

Another definition was given by Cool who identified a strategic group in "*a set of firms competing within an industry on the basis of similar combinations of scope and resource commitments*".

A central theme of the literature on strategic groups is that firm's performance is explained to a larger extent by the strategic group to which it belongs than by the idiosyncratic character of the individual firm[9].

With these works and in particular with Hunt's contributions, a new field of inquiry was born. The theory on strategic groups represents a new type of analysis that is midway between the industry level and the firm's level analysis developed by strategic management researchers. The concept of strategic groups enriched the SCP paradigm and IO perspective, offering to strategic management researchers a convenient taxonomy to compare and analyze different strategies of firms.

Two schools emerged in the development of the strategic group theory: the Industrial Organization school, rooted in economics and developed mainly at the Harvard University (which included researches by Hunt, Porter, Oster, Caves and Porter and Newman) and the so-called Purdue School of Strategic Management (with the contributions by Hatten, Patton and Cool):

- IO researchers adopted a multi industry focus often based on one or only few variables to identify strategic groups. The variables most commonly selected were firm size (Porter, 1973), advertising (Oester, 1982) and relationships with other industries (Newman, 1973). This approach – to some extent rooted in the SCP paradigm – usually relies on companies' data and on different performance indexes available in industry databases. A typical example of this stream of literature is the work of Porter that classified firms belonging to 43 different consumer industries in two strategic groups – leaders and followers – according to one strategic dimension: firm size. Other variables used in other researches as proxies for strategy are advertising (Porter 1976, Oyster 1982) or relationship with other industries (Newman 1973). According to Porter the definition of a competitive strategy is essentially the "choice of which strategic group to compete in" (Porter 1980[10]) and each group is likened to a "walled medieval city", which invests in one or more mobility barriers in order to prevent or make harder the entry.
- in contrast to the IO approach, strategic management researches focus on a single industry and adopt a multivariate approach with many variables used as proxies for resource and scale commitments. Strategy in this approach is essentially industry/context specific and represents a

[8] Porter, 1980, Competitive Strategy. Techniques for Analyzing Industries and Competitors, Free Press, New York.

[9] Cool, K., & Schendel, D. (1987). Strategic group formation & performance: the case of the U.S. pharmaceutical industry, Management Science.

[10] Porter M. E.,1980, Competitive strategy. Techniques for analyzing industries and competitors, Free Press.

pattern of choices which should take into account many elements such as available resources, the competitive position, management's risk attitude and industry structure. An example of this stream of literature is the work of Hatten (1974) for the US brewing industry, which identifies seven strategic groups using a multi-variable model relating performance (return on equity) to three manufacturing variables, three marketing variables and two structural variables.

The main purpose of studies in the IO literature is to analyze and understand the level of competition/rivalry within the industry and its impact on industry performance. The focus of strategic management researchers is more on the understanding of firm performance together with differences in strategic groups' results within the same industry. The different perspectives of the two streams of literature could be the reason why sometimes empirical researches on strategic groups has showed conflicting results. Despite the different approaches adopted, the two schools fully agree on the crucial point that persistent differences in performance exist between strategic groups.

1.2 A review of the strategic groups literature.

The starting point of the analysis of the literature on strategic groups is the famous review conducted by McGee and Thomas in 1986, which presents a survey of studies summarized in table 1[11]. This new line of academic enquiry was born with Hunt's doctoral dissertation (1972), aimed at explaining the variance of firms' performances in the US white goods industry in 1960.

The term strategic group was coined by Hunt; although there is no universally accepted definition. The most commonly used is Porter's, which classifies as members of a strategic group the firms within the same industry sharing a strategic dimension, i.e. pursuing similar strategies in key areas.

Hunt identified three main sources of asymmetry among competitors within the "white goods" industry:

i) the degree of vertical integration;

ii) the extent of product diversification;

iii) differences in product differentiations.

Hunt chose these strategic dimensions in his work because they were those ensuring the minimization of the asymmetry within each group. Accordingly, he grouped companies in white goods industry in four strategic groups: 1) full-line national manufacturers' brand producers; 2) part-line national manufacturer's brand producers; 3) private brand producers; 4) national retailers. Hunt observed that potential entrants faced different entry barriers depending on the group they belong to. He then tried to identify the entry barriers to each strategic group.

[11] McGee J., Thomas H., 1986, Strategic groups: theory, research &taxonomy, Strategic Management Journal, 7(2).

The concept of strategic groups has been empirically analyzed by many scholars. Newman (1978)[12] stated that strategic groups in the chemical goods industry could be defined according to the firm's relationship with other industries and classified companies in terms of their differing degree of vertical integration[13].

Table 1. Strategic groups researches[14]

Study	Industry	Basis for strategic group formation
Hunt (1972)	'White goods'	Product line basis —degree of product diversification —differences in product differentiation —extent of vertical integration
Newman (1973, 1978)	34 four-digit 'producer goods' industries: chemical processes	Degree of vertical integration
Porter (1973)	38 three-digit 'consumer goods' industries	Relative size of firm —leader/follower classification
Hatten (1974), Hatten and Schendel (1977)	Brewing industry	Manufacturing variables —number, age, capital intensity of plants Marketing variables —number of brands, price and receivables/sales Structural variables —eight-firm concentration ratio —firm size
Hatten, Schendel and Cooper (1978)	Brewing industry	Manufacturing, marketing and financial variables (leverage, merger/acquisition behavior)
Harrigan (1980)	Declining industries: receiving tubes synthetic soda ash baby foods acetylene percolator cigar leather tanners rayon	Dimensions of firms' strategic posture; strategic mapping used to identify groups
Caves and Pugel (1980)	U.S. manufacturing industry—sample	Relative size of firm
Oster (1982)	19 consumer goods industries from Compustat	Product strategy —Advertising/sales ratio
Ramsler (1982)	Banking industry —100 largest non-U.S. banks	Product market differentiation, size, geographic scope
Ryans and Wittink (1985)	Airline industry	Financial strategy clustering of residuals from capital asset pricing model (security returns)

13 Newman H.H., 1978, Strategic groups and the structure/performance relationship, review of Economics and Statistics.
14 McGee J., 1986, Thomas H. Strategic groups: theory, research &taxonomy, Strategic Management Journal, 7(2).

Study	Industry	Basis for strategic group formation
Baird and Sudharsan (1983)	Office equipment/ electronic computing	Financial Strategy variables —Leverage, current ratio, return on assets, dividend payment ratio, times interest earned, size
Primeaux (1985)	Textiles Petroleum	Size Investment behavior
Howell and Frazier (1983)	Medical supply and equipment	Customer groups served Customer needs served (due to Abell, 1980)
Hayes, Spence and Marks (1983)	Investment banking	Logit analysis involving match between characteristics of investment bank and characteristics of individual customers; four main groupings identified
Hergert (1983)	2450 SBUs representing 50 industries; broad sample of US manufacturing industry	Mix of variables (i) Advertising/sales (ii) R & D/sales (iii) Assets/sales (iv) Business unit sales/ parent sales (v) Market share
Dess and Davis (1984)	Paints and allied products	A range of 21 marketing variables
Hawes and Crittenden (1984)	Supermarkets	Marketing strategy variables (i) Target market (ii) Product (iii) Promotion (iv) Price (v) Buying (vi) Display
Lahti (1983)	Finnish knitwear industry, 1969–1981	Size: small, medium, large Nature of the product group
Hatten and Hatten (1985)	Brewing	Marketing strategy variables (i) Price (ii) Advertising (iii) Number of brands (iv) National relative market share

Porter's (1973) study of the consumer goods industry found that differences among firms could be essentially due to size and accordingly divided firms into two strategic groups: industry leaders and followers. Industry leaders were identified as the largest firms in the industry – accounting for around 30% of the industry sales revenues - while all the others were defined as followers. He found that the correlation between the rate of return of leaders and followers was very low and *"consistent with firm's profitability depending on their position within the industry and to the array of strategic groups in the industry"*[15].

He found that in general leading firms were more profitable than followers; industries where followers were more profitable than leaders seemed to be industries characterized by absent or low economies of scale (clothing, footwear, meat products, carpets) and/or highly segmented in many product lines (liquor, optical, toys and sporting goods, carpets). The industries in which leading firms were more profitable appeared to be those with heavy advertising (soap, perfumes, cutlery, soft drinks) and/or research expenditures.

The use of firm size in defining strategic group membership is also supported by the findings of Caves and Pugel's (1980) study of a few US manufacturing industries[16], who found that in some cases small firms were more profitable.

Studies of the US brewing industry by Hatten (1974)[17] and Hatten and Schendel (1977)[18] found that firms compete by investing in two main strategic areas, manufacturing and marketing, and identified seven strategic groups using a multi-variable model. These studies linked firm performance (return on equity) to three manufacturing variables (number, age and capital intensity of plants), three marketing variables (number of brands, price and receivables/sales) and two structural variables (concentration ratio and firm size). Hatten, Schendel and Cooper's model (1978)[19] applied to the same industry included not only manufacturing and marketing variables, but also financial indicators such as leverage, merger and acquisition behavior.

According to McGee and Thomas, Hatten's study has some limits since it refers to firms characterized by a very low degree of (product and geographical) diversification and it is therefore more focused on business strategy than on corporate strategy (diversification and vertical/horizontal integration).

Harrigan's (1980) study of declining industries like baby food, cigar, leather tanners, etc., followed the Porter approach in identifying strategic groups, using as variable the dimension of firms' strategic posture[20]. Oster's (1982) in his analysis of 19 consumer goods industries used the advertising policies in order to classify strategic groups[21]. In particular, he found that there were persistent differences between firms due to their advertising strategy (measured in terms of advertising outlays to sale ratio) and tested also the stability of these strategies over time in order to understand movements between different groups.

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[15] Porter M.E., 1979,The structure within industries and companies' performnce, The Review of Economics and Statistics, Vol. 61, Issue 2.

[16] Caves R. E. and Pugel T., Intra-industries differences in conduct and performance: viable strategies in US manufacturing industries, New York University Monograph,

[17] Hatten K. J., 1974, Strategic models in the brewing industry, unpublished doctoral dissertation, Purdue University.

[18] Hatten K.J., Schendel D.E., 1977, Heterogenity within the industry, Journal of Industrial economics, XXVI (2).

[19] Hatten K.J., Schendel D.E., Cooper A.C., 1978, A strategic model of the US brewing industry: 1952-19971, Academy of Management Journal, 21 (4).

[20] Harrigan K. R., 1980, Strategies for declining industries, Lexington Books,D.C. Heath, Lexington, Mass.

[21] Oster S., 1982, Intra-industry structure and the ease of strategic change, Review of Economics an Statistics, LXIV (3).

Oster's study found that the long term durability of firm's investments in advertising is crucial to guarantee stability to the group structure. In this respect, the research confirms the value of advertising as a strong entry deterrent or mobility barrier within the consumer goods industry.

Some other scholars used finance variables as basis for groups differentiation. Ryans and Wittink (1985) studied the airline industry and found that firms belonging to the same strategic group tended to register similar trends in their stock prices[22], according to the capital asset pricing model. Baird an Sudharsan's study (1983) classified firms in the office/equipment/electronic computing in terms of leverage and return on assets[23]. They identified seven strategic groups characterized by stability over time and differentiated only on the basis of financial strategies.

A very interesting study was made in 1985 by Primeaux[24], who attempted to link strategic groups and life cycle notions in the textile and petroleum industries. In particular, he assumed that investment behavior, measured by net capital expenditure, is a crucial variable in order to identify the life cycle's stage of an industry. Using a relative size dimension, he also showed that strategic groups can be affected by the industry life cycle stage in some specific industries.

Howell and Frazier's (1983) investigation of the medical supply industry showed that the differences between groups are mainly due to the degree of scope and differentiation on customer groups and to customer needs served by firm[25]. Therefore, they formed strategic groups on the basis of traditional marketing variables.

An other analysis was applied in the banking industry by Ramsler (1982) and Hayes, Spence and Marks (1983). Ramsler focused on non-US banks with a presence in the US market and found that companies belonging to the same strategic group tended to pursue similar strategies in entering the US banking market[26].

Hayes, Spence and Marks (1983) focused on the investment banking industry and aggregated firms in four groupings through a logit analysis that matched characteristics of the investment banks with the needs of bank's customers[27].

Hergert's study of 50 manufacturing industries (1983) – regarding seven broad categories (chemicals and allied products, rubber and plastic products, leather products, electric and electronic equipment, instruments and related products, and miscellaneous manufacturing) - used as a strategic group

[22] Ryans A.B., Wittink D.R., 1985, Security returns as a basis for estimating the competitive structure in an industry, in H. Thomas and D. M. Gardner, Strategic Marketing and Management, John Whiley, Chichester.

[23] Baird I.S., Sudharsan D., 1983, Strategic groups: a three mode factors analysis of some measures of financial risk, Working Paper, 931,Bureau of Economic and Business Research, University of Illinois at Urbana-Champaign.

[24] Primeaux W.,1985, A method for determining strategic groups and life cycle stages of an industry ,in Thomas H. and Gardner D. M., Strategic marketing and management, Jon Wiley, Chichester, 1985.

[25] Howell R.D., Frazier G.L., 1983, Business definition and performance, Journal of Marketing,47.

[26] Ramsler M.,1982, Strategic group and foreign market entry in global banking competition, unpublished doctoral dissertation, Harvard University.

[27] Hayes s.l., spence A. M., Marks D.V.P., Competition in the investment banking industry, Harvard University Press, Cambridge, Mass.

membership a mix of variables like advertising, R&D, assets, sales, and market share[28]. Hergert also studied the influence of strategic groups on the industry's profitability.

Lahti's (1983) study of the Finnish knitwear industry used two variables, size (large, medium, small) and the nature of the product, to form strategic groups[29]. He found that there are "real" and meaningful differences between strategies and economic performance of each size grouping. For example, a small firm is usually forced to stay in a specific segment and invest in production function.

A study of the paints industry by Dess and Davis (1984) used a multivariate model and found that strategic groups differ on 21 marketing variables[30]. Differently from the previous studies, this analysis uses a definition of strategy as "intention" and not as strategy realized. Also Hawes and Crittenden (1984) and Hatten and Hatten (1985) adopted marketing variables in the formation of strategic groups in retailing and brewing industries. Hawes and Crittenden in their work showed partial evidence of a relationship between strategic groups and economic performance.

The literature on strategic groups mainly focuses on the central theme that group membership affects performance. Linkages between strategic groups and performance were found in consumer goods (Porter, 1973), chemical process (Newman, 1973), brewing (Hatten and Schendel, 1977; Hatten, Schendel and Cooper, 1978), industrial products (Hambrick, 1983[31]), paints and allied products (Dess and Devis, 1984), US insurance (Fiegenbaum and Thomas, 1990[32]), and retail mail-order (Parnell and Wright, 1993[33]) industries. Nevertheless, not all researches have supported a strong relationship between strategic group membership and performance (McGee and Thomas 1986). Ketchen and associates' study (1997) found that group membership explains only eight percent of a company's performance[34].

1.3 Mobility barriers

From a theoretical point of view, the strategic group concept is based on two pillars: mobility barriers and intra-industry competition. These pillars are crucial in explaining the homogeneity of firms' performance between a specific strategic group and the heterogeneity of performance among different strategic groups.

[28] Hergert M., 1983, The incidence and implications of strategic groupings in US manufacturing industries, unpublished doctoral dissertation, Harvard University.

[29] Lahti A., 1983, Strategy and performance of a firm: an empirical investigation in the knitwear industry in Finland in 1969-81, Heslinki School of Economics.

[30] Dess G.G., Davis P.S., 1984, Porter's (1980) generic strategies as determinants of strategic groups membership and organizational performance, Academy of Management Journal, 27.

[31] Hambrick D.C., 1983, Some tests of the effectiveness and functional attributes of Miles and Snow's strategic types, Academy of Management Journal, 26 (1).

[32] Fiegenbaum A., Thomas H., 1990, Strategic groups and performance: the US insurance industry, (1970-84), Strategic Management Journal, 11.

[33] Parnell J.A., Wright P., 1993, Generic strategy and performance: an empirical test of the Miles and Snow typology, British Journal of Managment 4 (1).

[34] Ketchen D.J., Combs J.G., Russell C.J. et al., 1997, Organizational configurations and performance: a Meta-analysis, Academy of Management Journal, 40.

The concept of mobility barriers was developed by Caves and Porter in 1977[35] and was built on Bain's notion of "entry barrier" of an industry (1968)[36]. These scholars argued that if barriers to entry are present in an industry, the concept of mobility barriers also exists between strategic groups. Persistent differences in performance between strategic groups can be explained by the existence of mobility barriers which prevent incumbent firms' movements/repositioning among different cluster of firms and limit the erosion of the firms' competitive advantage through competition or imitation.

According to Porter, entry/mobility barriers are in part specific to the strategic group and do not entirely depend on the industry. These barriers not only prevent entry from new comers in the industry but also prevent entry in a specific strategic group from a member of an other strategic group (intergroup mobility).

By borrowing an idea from IO economics, strategic groups are described as "walled medieval cities" where bulwarks or the collective activities carried out by group's firms act as barriers to access from competitors.

Leask (2004)[37] defined strategic groups as stable structures protected by mobility barriers and pursuing different strategies affecting performance. The existence of such barriers protects each strategic group from the competition of firms outside the group and leads to differences in performance (Short et al. 2007; Tywoniak and al. 2007[38]).

According to McGee and Thomas "*A firm within a group makes strategic decisions which cannot readily be imitated by firms outside the group without substantial costs, significant elapsed time, or uncertainty about the outcome of those decisions"*[39].

The height of mobility barriers depends on critical strategic decisions (key strategic variables) which affect the cost of entering into a strategic group. For Bidaults (1988) this entering/mobility cost is due to non-recoverable investments that any newcomer have to sustain in order to pursue the strategy adopted in the strategic group[40]. Investments in tangible and intangible assets, together with the uncertainty surrounding the possibility of successfully copying the competitor's strategy, contribute to elevate mobility barriers[41]. Such barriers may stem from the actions of an individual company or by the collusion between strategic groups' members[42]. Cool & Schendel found that the main barrier in the pharmacy and insurance industry is represented by the distribution system[43].

[35] Caves R.E., Porter M. E., 1977, From entry barriers to mobility barriers: conjectural decisions and contrived deterrence to new competition, Quarterly Journal of Economics, 91.
[36] Bain J.S., 1968, Industrial organization (second edition), John Wiley, New York.
[37] Leask G., Strategic groups & the resource based view: natural complements enhancing our understanding of the competitive process, Working Paper, Ashton University.
[3838] Short J. C., Ketchen D. J., Palmer B. T.,Hult T. M., 2007, Firm, strategic group, & industry influences on performance, Strategic management Journal. Tywoniak S., Galvin P., Davies J., New institutional economics' contribution to strategic groups analysis, Managerial & Decision Economics.
[39] McGee J., Thomas H. Strategic groups: theory, research & taxonomy, Strategic Management Journal, 1986.
[40] Bidault F, 1988, Le champe strategique de l'entreprise, Economica.
[41] Lippman S. A., Rumelt R. P., 1982, Uncertainty imitability: an analysis of interfirm differences in efficiency under competition, Bell Journal of Economics.
[42] Dranove D., Peteraf M.,1998, Do strategic groups exist? An economic framework for analysis, Strategic management Journal.
[43] Cool K., Schendel D., 1987, Strategic group formation & performance: the case of pharmaceutical industry, Management Science.

McGee and Thomas (1986) identified a taxonomy of mobility barriers, distinguishing three broad categories described in table 2: market-related strategies, industry-supply characteristics and firms' characteristics.

Table 2. Source of mobility barriers

Market-related strategies	Industry supply characteristics	Characteristics of firms
Product line User technologies Market segmentation Distribution channels Brand names Geographic coverage Selling systems	Economies of scale: production marketing administration Manufacturing processes R & D capability Marketing and distribution systems	Ownership Organization structure Control systems Management skills Boundaries of firms —diversification —vertical integration Firm size Relationships with influence groups

Source: McGee J., Thomas H. Strategic groups: theory, research &taxonomy, Strategic Management Journal, 1986.

Many mobility barriers are endogenous to the firm and depend on strategic decisions adopted by firm's management[44]. Market related barriers – which include product line, technology embodied in the product, distribution channels, brand names, product differentiation – are the outcome of firms' strategic choices involving initial investment expenditures and elapsed time to be fully exploited.

Mobility barriers stemming from industry supply characteristics are related to scale economies due to the amount of assets that could be invested in technological and manufacturing capabilities, in advertising and distribution systems as well as in Research & Development.

Other kinds of mobility barriers are linked to the firm's organizational structure and its efficiency, firm size and management skills. Chandlers (1962)[45] outlined the strict relationship between strategic choices and organizational structure which undoubtedly is difficult to be measured. On this issue, Williamson's study[46] regarding Chandlers' analysis of two possible kinds of structures, functional and divisional, together with the researches of Wrigley (1970) and Rumelt (1974)[47] suggested some guidelines for assessment.

The nature and the degree of diversification along with the extent of vertical integration are crucial elements in order to define the boundaries of a firm. When there are significant cost savings from vertical integration, large firms in many industries are all vertically integrated in order to exploit cost advantages.

44 Leask G. Parker D., Strategic Group theory: review, examination and application in the UK pharmaceutical industry.

45 Chandlers A D., 1962, Strategy and structure: chapters in the history of the industrial enterprise, MIT Press, Cambridge.

46 Williamson O.E., 1970, Corporate Control and Business behavior, Prentice-Hall, Englewood Cliffs.

47 Wrigley L., Divisional autonomy and diversification, unpublished DBA thesis, Harvard Business School; Rumelt R. P., 1974, Strategy, Structure and economic performance, Division of Research, Harvard University Graduate School of Business Management.

These cost savings can also derive from diversification when the different products/brands are market related and it is possible to share the same technology. Small firms may try to compensate cost advantages deriving from size, offering high quality/high technology products to niche market segments. In addition, some scholars identified as a source of barrier economies of management that can stem from divisional organizational structures and from synergies deriving from pooling of talents specialized on related issues (McGee and Thomas,1986).
The extension or reduction of firm's boundaries require time and it is risky and difficult to reverse. In strategic decisions, management has to take into account not only cost issues but also risk issues. According to the portfolio theory, the pooling of uncorrelated risks has the effect to reduce the overall risk.
As seen above, there are many firm-specific sources of mobility barriers: organizational structure, management capabilities, the degree of diversification and vertical integration. Another source of barrier is firm's ownership (nature of shareholders, family influence, multi-national, relationship with government …) which influences the firm's target rate of return or the time horizon over which it should be reached (McGee and Thomas 1986).
The different height of mobility barriers has implications in terms of different degrees of protection of strategic groups. In this respect, a hierarchy of strategic groups may exist in each industry. Companies enter the industry via the group with the lowest barriers and then follow an evolutionary pathway to more profitable positions. Since the repositioning among groups is possible only after significant investments and after the elapse of considerable time in order to acquire skills, knowledge, competences and experiences to overcome the barrier, firms enter the industry via the less protected group. Only once developed the necessary competence and experience, they attempt the successful assault to the next most advantageous market position. In the creation of mobility barriers, two elements are crucial: the size of investments in tangible and non-tangible assets and the uncertainty regarding the ability of a companies to copy successful competitors[48].
For Porter and Caves the height of mobility barriers and group inaccessibility are directly proportional to the group profitability: strategic groups with higher profits are protected by higher mobility barriers, more difficult to be overcome[49].
In addition, Leask sustains that the environmental changes do not affect strategic groups in the same way due to the different level of groups' protection[50]. Other researchers argued that many factors which make difficult intra-group mobility are related to proprietary information [51]and that the low mobility between groups is due more to specific characteristics of the individual firm and to its accumulated investments

[48] Lippman S.A., Rumelt R.P., 1982, Uncertain imitability: an analysis of inter firm differences in efficiency under competition, Bell Journal of Economics.
[49] Caves R.E., Porter M. E., 1977, From entry barriers to mobility barriers: conjectural decisions and contrived deterrence to new competition, Quarterly Journal of Economics, 91.
50 Leask G., 2004, Is there still value in strategic group theory?, Aston Business School Research Papers.
[51] [51] Lippman S.A., Rumelt R.P., 1982, Uncertain imitability: an analysis of interfirm differences in efficiency under competition, Bell Journal of Economics.

than to cumulative mutual investments[52]. This stream of literature is named "resource based" view of firms and it is represented by the contributions of Wernfelt (1984)[53], Barney (1991), Leask[54]. These scholars emphasized the uniqueness of firm's competences and resources in strategy definition, implementation and performance.

Many studies showed that strategic groups are stable intra-industry structures thanks to the existence of mobility barriers.

Mascarenhas and Aaker (1989)[55] observed that mobility barriers are at the core of the notion of strategic group and proposed a further definition of a strategic group as "*a grouping of businesses within an industry that is separated from other groupings of business by mobility barriers to entry and exit"*[56]. Their findings regarding the existence of a higher mobility among less protected strategic groups - where there are only a few barriers to be overcome - are consistent with Caves and Porter' study (1977).

Mascarenhas and Aaker concluded that "*The results suggest credibility for the strategic group concept motivated by mobility barriers…A high degree of group stability was observed…indicating that mobility barriers did exist"*.

In defining strategic groups, it is crucial to identify the main mobility barriers which characterize the industry; in other words, strategic groups should be formed on the basis of key strategic decisions on which the market position is built and sustained within a given industry. The classification of strategic groups by their mobility barriers (or on the basis of similar concepts such as idiosyncratic capital and isolating mechanism[57]) underlines the concept that group firms benefit from cost advantages due to the group membership and stresses the elapse time and high investments required to new potential "entrants" in order to vault the barriers. *Ex ante* the investment decisions for new "comers" are risky as mobility costs are sunk.

1.4 The theory of intra-industry competition

The second pillar of the strategic group theory is the theory of intra-industry competition. Associated with the concept of mobility barriers is the idea that competition, or the level of rivalry, differs within and between different strategic groups (Cool and Dierickx, 1993[58]; Peteraf, 1993[59]; Porter, 1979[60]). In particular, the existence of barriers to mobility together with collusion mechanisms leads to a low level of rivalry within strategic groups. The theory of oligopoly (Stigler 1964[61]) argues that in some industries

52 Bogner W. C., 1991, Pattern of intra-industry competition: a dynamic analysis of theoretical foundations of strategic groups, 1991University of Illinois.
53 Wernerfelt B., 1984, A resource based view of the firm: ten years after, Strategic Management Journal,16.
54 Leask G., Parker D., Strategic group theory: review, examination and application in the UK pharmaceutical industry.
55 Mascarenhas B., Aaker D.A., 1989, Mobility barriers and strategic groups, Strategic management Journal,10.
56 Mascarenhas B., Aaker D. A. (1989), Mobility barriers and strategic groups, Strategic Management Journal,10.
57 Rumelt (1981) underlined the uniqueness of firm which protect itself through "isolating mechanism" and the notion of "idiosyncratic capital".
58 Cool K., Dierickx I., 1993, Rivalry, strategic groups and profitability, Strategic Management Journal, 14 (1).
59 Peteraf M.A., 1993, Intra-industry structure & the response towards rivals, Managerial & Decision Economics, 14 (6).
60 Porter M.E., 1979, the structure within industries & companies' performance, Review of Economics and statistics, 61 (2).
61 Stigler G.J., 1964, A theory of oligopoly, Journal of Political Economy, 72.

there are some forms of coordination (based on tacit or explicit group consensus) which reduce the level of rivalry within the group. Caves and Porter (1977), Peteraf (1993) and Porter (1979) suggested that the level of competition within strategic groups is low due to firms' awareness of mutual dependence or firms' cooperation or tacit collusion.

The theory of intra-industry competition - borrowed from SCP paradigm – argues that the relative size of a company matters because it can either act as an incentive for firms to collude or bring to greater rivalry. As seen above, group membership implies a common view of how to compete. When firms of a specific industry have similar size and serve the same markets/customers, it is more likely that their own common interests bring them to strictly cooperate through mechanisms such as collusion. On the contrary, when an industry is characterized by considerable competitive diversity and by a large number of companies, it is more likely that profits erode through a more intense competition.

Some scholars (e.g. Ketchen et al. 1993[62]) defined strategic groups on the basis of strategic alliances or intra-firm networks. Duyster and Hagedoorn (1995) stated that firms with similar resources are very likely to have the same suppliers or customers, leading to greater communication and cooperation within the group[63]. However, according to Jayachandran, Gimeno and Varadarajan[64] collusion or cooperation mechanisms may be challenged by a major innovation. They stated that "*companies may be inclined to see the mutual dependence as a preferable alternative to a frenzied rivalry, but they would not reject the possibility to dominate the market with a major innovation*"[65].

One of the first empirical studies focused on inter-group mobility was Oster's research in 1982. Adopting the same methodology used by Porter in order to identify strategic groups (on the basis of low/high advertisers), she analyzed the dynamics of strategic groups memberships in 19 industries of consumer goods during 1971-1977 period. She found that strategic groups were stable structures within the industry with low movements between different groups. This research was criticized for its methodology based on a single variable for the identification of group membership (low versus high advertisers) and also for the assumption that membership can change only on an annual basis.

Other scholars, conversely, concluded that the level of rivalry is more intense within strategic groups rather than between strategic groups (McNamara, Deephouse and Luce, 2003[66]). Other authors (Dess and Devis 1984; McGee and Thomas 1986; Thomas and Pollock, 1999[67]) concluded that rivalry is greater between firms that are similar in terms of key strategic and structural dimensions.

[62] Ketchen D.j., Thomas J.B., Snow C.C., 1993, Organizational configurations & performance: a comparison of theoretical approaches, Academy of Management Journal, 36 (6).

[63] Duister G., Hagedoorn J., 1995, Strategic groups &inter-firms networks in international high-tech industries, Journal of Management Studies, 32 (3).

[64] Jayachandran S., Gimeno J., Varadarajan P.R., 1999, The theory of multimarket competition: a synthesis & implications for marketing strategy, Journal of marketing.

[65] Jayachandran S., Gimeno J., Varadarajan P.R., 1999, The theory of multimarket competition: a synthesis & implications for marketing strategy, Journal of marketing.

[66] McNamara G., Deephouse D. L., Luce R. A., 2003, Competitive positioning within& across a strategic group structure: the performance of core, secondary & solitary firms, Strategic Management Journal.

[67] Thomas H., Pollock T., 1999, From IO economics S-C-P paradigm through strategic groups to competence based competition: reflection on the puzzle of competitive strategy, British Management Journal.

According to Porter, the presence of a strategic group impacts on inter-firm rivalry and hence the average and dispersion of profits in an industry. Different strategies reduce the possibility for oligopolists to activate collusion mechanism due to the different preferences regarding key decisions such as market price, the launch of new product and so on.

Porter argued that there are three factors which influence the impact of strategic groups on industry rivalry and also on the way in which groups compete with each other[68]:

- the number and size distribution of groups;
- the strategic “distance” between groups;
- the market interdependence.

Ceteris paribus, more numerous and equal in size are the strategic groups, more the strategic asymmetry strengthens rivalry. Conversely, if a strategic group represents a small share of the market, whereas another one represents a large portion of market’ share, then the strategic asymmetry has low influence on rivalry. In fact, in such a case it is less likely for the small strategic group to affect the behavior of the larger one. Large groups whose companies markedly differ in terms of size and and risk’s preference are inclined to be characterized by a greater internal rivalry than smaller groups. Members of a group which have the same target market may quickly imitate the competitive action of a rival (McGee et al. 1995).

The distance between strategic groups regards the degree of differentiation of strategic groups’ strategy in terms of key decision variables such as advertising, production’s organization and cost structure. Other things held constant, greater is the strategic distance between groups, lower is the probability to build a tacit coordination between groups and more intense is competition between groups than within strategic groups.

The third dimension of intergroup rivalry is market interdependence, namely the degree to which strategic groups compete for the same markets/customers rather than customers in different market segments. Higher is market interdependence, more intense will be the impact of the diversity of strategies on competition. Conversely, if strategic groups are focused on different market segments, then the influence of their behavior on each other is less intense.

The pattern of intra-industry competition is determined by the interaction of all these three dimensions. According to Porter, the impact of rivalry on a company depends also on the position of the other competitors. The presence of different strategic groups, on the other hand, have an impact not only on the rivalry in the industry but also on the pattern of rivalry within the industry. Different groups can benefit from greater bargaining power towards suppliers and customers than other groups due to difference in scale or to the degree of product differentiation stemming from different strategies adopted.

Empirical findings not always support the assumption that rivalry between strategic groups is greater than within strategic groups. The results are mixed and contradictory. According to Denglos (2002)[69] the lack

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[68] Porter M.E., 1979, The structure within industries and companies’ performance, The Review of Economics and Statistics, Volume 61, Issue 2.
[69] Denglos G., 2002, Groupes strategiques, comportements concurrentiels et performance, dans F. Le Roy (ed.), La Concurrence: entre affrontementet connivence, Vuibert.

of consistent results could be due to the paradox of the strategic groups theory that assumes higher competition between groups rather than within groups, while at the same time groups are formed from mobility barriers reducing rivalry between groups. The divergent results regarding inter and intra-group rivalry may also due to the different measures of competition used in the different researches.

1.5 Strategic group theory and the development of new theoretical approaches

In the nineties many researchers expressed dissatisfactions towards the strategic groups theory and the numerous empirical studies generated by this stream of literature (among these Barney and Hoskisson 1990[70]).

Dissatisfaction mostly regards inadequate model specification, insufficient theoretic construction, confused selection of strategic variables to classify groups and findings' inconsistency of empirical studies. Many authors found that firms belonging to the same strategic group show very different performance (Fiegenbaum & Thomas 1990[71], Fiegenbaum et al. 1988[72], Barney and Hoskisson 1990).

Many criticisms were already raised in the McGee and Thomas study in 1986. They observed that *"confusion reigns about the underlying meaning of the term strategic group. Some writers appeal to structural concepts such as size; other clearly choose performance characteristics whether expressed as profitability, market share, or leaders/followers"*.

In 1990 Barney and Hoskisson asserted that two important claims of the strategic group theory remained unproved: the existence of strategic groups in an industry and the linkage between firms' performance and group membership. In addition, the assumption that "*there are groups of firms suggests that firms are not idiosyncratic in strategically relevant ways"*.

At the end of the 1980s and in the 1990s other streams of literature emerged around the idea that strategic groups should be identified in a way that allows some strategic variance among firms within each group. For this reason new theoretical approaches emerged, the cognitive perspective (Fombrun and Zajac, 1987[73]; Osborne et al., 2001[74]; Peng et al., 2004[75]; Porac et al., 1995[76]; Reger and Huff, 1993[77]) and the resource based theory (Dierickx and Cool,1989[78]; Mehra, 1996[79]).

[70] Barney J.B., Hoskinsson R.E., 1990, Strategic groups: untested assertions and research proposals, Managerian and Decisions Economics,11.
[71] Fiegenbaum A., Thomas H., 1990, Strategic groups and performance. The U.S. insurance industry, 1970-1984, Strategic Management Journal, 11.
[72] Fiegenbaum A., McGee J., Thomas H., 1988, Exploring the linkage between strategic groups and competitive strategy, International Studies of management and Organization, 18 (1).
[73] Fombrun, C.J., and Zajac, E.J. (1987). 'Structural and perceptual influences on intra-industry stratification.' Academy of Management Journal, 30.
[74] Osborne, J.D., Stubbart, C.I., and Ramaprasad, A. (2001). 'Strategic groups and competitive enactment: a study of dynamic relationships between mental models and performance.' Strategic Management Journal, 22.
[75] Peng, M.W., Tan, J., and Tong, T.W. (2004). 'Ownership types and strategic groups in an emerging economy.' Journal of Management Studies, 41.
[76] Porac, J., Thomas, H., Wilson, F., Paton, D. and Kanfer, A. (1995). 'Rivalry and the industry model of Scottish knitwear producers'. Administrative Science Quarterly, 40.
[77] Reger, R.K., and Huff, A.S. (1993). 'Strategic groups: a cognitive perspective.' Strategic Management Journal, 14.
[78] Dierickx, I., and Cool, K.O. (1989). 'Asset stock accumulation and sustainability of competitive advantage.' Management Science, 35.
[79] Mehra, A. (1996). 'Resource and market based determinants of performance in the US banking industry.' Strategic Management Journal, 17.

The theory of cognitive strategic groups suggests that managers have cognitive maps of intra-industry structure (Bogner and Thomas, 1993[80]) which lead to the formation of strategic groups different from those identified under the industrial organization approach (Reger and Huff, 1993[81]). Bogner and Thomas' study (1993) analyzed and compared the two different approaches concluding that competition and performance are more directly affected by cognitive perceptions of strategic groups than by industrial organization groupings. The cognitive perspective of strategic groups is based on the idea that managerial perceptions of similarities and performance among players affect strategic decision making. The way companies see themselves and their competitors impacts on strategy definition and consequently on industry structure. An important assumption in defining cognitive strategic groups is the common perception and interpretation of external events and the adoption of future strategic decisions based on these common perceptions (Porac et al. 1995).

Regardless of limited empirical evidence, according to Reger and Huff (1993) strategic groups identified according to manager's perceptions predict better the performance differences across firms in a particular industry. Studying the relationship between cognitive groups and performance, they found that there was homogeneity in performance among firms within the same groups and heterogeneity between groups in the case of U.S. regional banks. Nevertheless, they admitted that the small size of the sample used in their research did not truly proved the existence of a causal link between cognitive strategic group membership and performance.

It is evident that the cognitive approach implies many difficulties for researchers since managerial perceptions are not observable. That is why empirical studies on cognitive strategic groups are based on the use of simple approximations to cognitive models. For instance, Peng et al. (2004) have proved that the ownership is a powerful criterion to predict the existence of strategic groups. Another criterion used for identifying cognitive groups was the production function approach (Athanassopoulos, 2003[82]; Day et al., 1995, and Prior and Surroca, 2006[83]).

Many scholars recognized the potential complementary between the "objective" (or "economic") and the cognitive approach to strategic groups. Scott suggested that "*perception measures are necessary if one wants to predict the choices or behaviors of members of the organization, but they are not sufficient if one wants to predict the result of those choices"*[84].

Dissatisfaction with the strategic group theory led to- on one side - a modified theory of group structure (the cognitive approach) and, on the other side, on a renewal interest in firms' resources – and not

[80] Bogner W.C., Thomas H., 1993, The role of competitive groups in strategy formulation: a dynamic integration of two competing models, Journal of Management studies, 30 (1).

[81] Reger R.K., Huff A.S., 1993, Strategic groups: a cognitive perspective, Strategic Management Journal,14 (2).

[82] Athanassopoulos, A.D. (2003). 'Strategic groups, frontier benchmarking and performance differences: evidence from the UK retail grocery industry.' Journal of Management Studies, 40.

[83] Prior, D., and Surroca, J. (2006), 'Strategic groups based on marginal rates. An application to the Spanish banking industry.' European Journal of Operational Research, 170.

[84] Scott W. R.,1981, Organizations: rational, natural &open systems, Englewood Cliffs, NJ: Prentice-Hall.

strategic group membership – as reference for firm strategy (Barney 1991[85], Collis 1991[86], Grant 1991[87]). The resource based theory – which is based on the first studies of Penrose (1959)[88] and Wernerfelt (1984)[89] - stresses the importance of firms' unique resources and competences in strategy formulation, implementation and performance. Resources include both physical (plants, equipment, technology) and human (quality of managers and employees) capital and organizational capital resources.

Resource based scholars argued that the main determinant of firm performance is its capabilities to develop and manage valuable resources. For this theory the source of competitive advantage lies primarily within the firm and it occurs when a company develops and implements a valuable strategy that is not simultaneously adopted by its competitors (Peteraf 1993)[90]. It is the firm's unique set of resources and skills which protects a company from the assault of other competitors and can ensure successively performance through differentiation.

While initially the resource based theory was conceived as alternative to the strategic group theory, subsequently some linkages between the two approaches have been found:

1) as mentioned in the previous paragraphs strategic group theory is based on the idea of mobility barriers: one of most common barrier is given by inimitable resources such as firms' patents which prevent or make harder the entry of newcomers;
2) Bogner, studying the U.S. pharmaceutical industry (1991)[91] suggested that a "competitive group" is a more comprehensive group which adds to strategic group the value of past experience, accumulated resources and the "degree of freedom" to shift position and move to another strategic group.

   The resource based perspective can enrich strategic group analysis, recognizing the role played by firms' unique resources and capabilities. Both strategic group theory and resource based perspective try to explain the variance within the industry. According to Leask[92], the main difference between these two theories lies in the different approach: while the resource based theory adopts a pre-strategy position, counting on firm's unique set of resources and skills for the strategy development and implementation, the strategic group theory adopts a post-strategy positions, formulating a taxonomy of strategies pursued by firms, "*where individual firms are classified into strategic groups through comparison of past strategic investments*"[93].

[85] Barney J.B., 1991, Firm resources and sustained competition, Journal of Management , 17 (1).
[86] Collis D. J.,1991, A resource based analysis of global competition: the case of the bearings industry, Strategic Management Journal,12.
[87] Grant R. M.1991, The resource based theory of competitive advantage: implications for strategy formulation, California Management review, 33 (3).
[88] Penrose E., 1959, The theory of growth of the firm, Oxford University Press.
[89] Wernefelt B., 1984, A resource-based view of the firm: ten years after, Strategic Management Journal, 16 (3).
[90] Peteraf M.A., 1993, The cornerstones of competitive advantage: a resource based view, Strategic management Journal.
[91] Bogner W.C., 1991, Pattern of intra-industry competition: a dynamic analysis of theoretical foundation of strategic groups: 513. University of Illinois at Urbana Champaign.
[92] Leask G., 2005, Integrating strategic groups and the resource based perspective: understanding the competitive process, European Management Journal.
[93] Leask G., 2005, Integrating strategic groups and the resource based perspective: understanding the competitive process, European Management Journal.

1.6 Summing up

The concept of strategic group has earned a great deal of attention within the strategic management and industrial organization literature (McGee and Thomas, 1986). The strategic group theory has disclosed a new level of analysis that was in the middle between the industry level and the firm's level analysis. The concept of strategic groups enriched the SCP paradigm and IO perspective, offering to strategic managerial researchers a convenient taxonomy to compare and to analyze different strategies of clusters of firms. As underlined by McGee and Thomas these groups are called strategic groups because the criteria on which they are identified should essentially be "*long term in nature and costly to reverse*".

As seen above, the debate in the literature about how strategic groups should be identified (Fiegenbaum and Thomas, 1990) still continues and the main difference in the numerous existing studies regards the strategic dimension used to classify groups. On one side, they are based on a single variable such as size or advertising, on the other side they are based on the use of multiple variables. As underlined in the previous paragraphs, strategic group analysis shows a high sensitivity to the variables adopted. An in depth knowledge of an industry is necessary to adequately specify the set of variables to be used in any strategic groups analysis that should accurately reflect firms' strategic choices[94]. The merit of these studies relies on the finding that differences between firms do exist and are linked to strategic decisions. Groupings are therefore the outcome of different strategic choices. However, the link between strategic group membership (or strategic choice) and performance still remains not conclusively proven empirically.

As underlined by Leask in its work "Is there still value in strategic group research?" in 2004[95] - in which the author makes a review of the rise and fall of the strategic group theory – the theory continues to offer a valuable way to grouping firms according to their strategy. Leask also identifies some guidelines to follow in order to avoid some problems which affected previous works and to give consistency to researches' outcomes:

1. The set of variables to use in any strategic groups analysis should be industry-specific and should accurately reflect firms' strategic choices; in addition, the inclusion or exclusion of a specific variable should be supported by theoretical reasons;
2. Wherever it is possible, it is useful for the selection of strategic variable to make reference as starting point to previous studies in order to enrich industry-specific data base on strategic choices;
3. To check the methodology and the set of variables used in order to avoid multicollinearity' s problems;

[94] McGee J., Thomas H., 1986, Strategic groups: theory, research & taxonomy, Strategic Management Journal, March 1986.
[95] Leask G., 2004, "Is there still value in strategic group research?", Aston Business School Research.

4. In case of use of clusters' analysis, the data set should be standardized to remove the effects of scale.

However, it is undoubtedly – as stated by McGee and Thomas in their famous review - that the difficulty to apply rigorous methodologies to the area of strategic decision-making is very high as well as the difficulty to count on suitable data bases for strategic researches.

Taking into accounts these useful recommendations, the application of industry specific strategic group researches offers a valuable tool to compare and to analyze different strategies of clusters of firms and to make sense of competitive dynamics.

2. The Luxury Industry: the consolidation jungle

2.1 The concept of Luxury

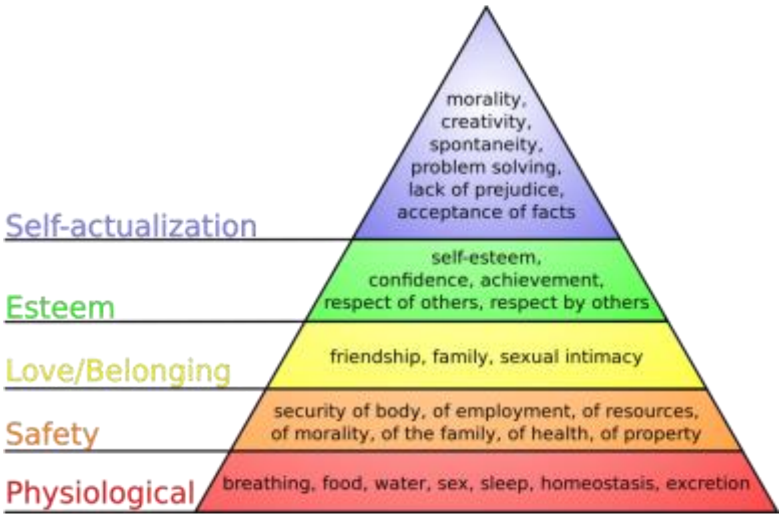
Defining in a precise and static way what luxury is represents a difficult task. It is a highly relative concept and it identifies with all of which an individual can give up without suffering hardship; as Coco Chanel said " luxury begins where necessity ends." It is clear that these definitions do not identify a clear line of distinction between what luxury is and what is not. The classification of a product as a luxury is in fact subject to its historical time, place and individual, also, with the passage of time what initially is luxury tends to become 'necessary'.

In business literature there is no consensus about the definition of luxury products and the existing concepts remain a little bit "blurry"[96]. Thus, luxury is a dynamic and evolving concept, but is always the result of a social stratification: luxury is reserved to an inner circle of people.

Currently under the term luxury a very wide area of interest is classified, including a multitude of different segments: apparel, shoes and accessories, food, cars and arts. In such a context, is the brand that provides a product with the connotation of luxury through its capacity to evoke dreams and desires.

Maslow developed a theory in his paper "A Theory of Human Motivation" in which he groups needs into a hierarchy sorting them into five different categories[97]. According to him the hierarchy can be graphically represented as a pyramid and individuals are motivated to achieve certain needs starting from the lower level of the pyramid and gradually moving towards the top.

Figure 1. Maslow's hierarchy of needs



Source: J. Finkelstein, 2006, Diagram of Maslow's hierarchy of needs.

[96] Heine, K., 2012, The Concept of Luxury Brands, 2nd Edition.
[97] Maslow A, 1943, "A Theory of Human Motivation", Psychological Review 50.

Looking at this sequence of needs it emerges that luxury goods are not positioned at the top of the pyramid, as one might think, instead they are located exactly in the middle, in the levels of needs for esteem and needs for self-actualization[98].Given this position, luxury goods, despite not being necessary, are able to fulfill needs that are neither marginal nor irrelevant, thus, resulting less frivolous and more connected to human nature.

For economists, a luxury good is a product whose demand elasticity with respect to income is greater than one[99]. This means that the demand for luxury goods increases more than proportionally to the rise in income.

Sociologists and strategic management researchers focus more on the elements regarding the marketing mix developed for this specific category of goods. In this view, luxury goods are those products which are capable of providing a status of prestige to those who are able to enjoy it, and which are characterized by an excellent quality and a premium price[100].

The consumer-oriented approach aims to identify the characteristics of luxury goods through an empirical study of luxury consumers. One of the most famous studies on this issue is the Dubois et al.'s study (2001) [101] which gives the following definition of luxury product.

Figure 2. The Definition of Luxury Products by Dubois, Laurent, and Czellar (2001)

Excellent quality	The first notion is that of perceived excellent quality. The mental association between luxury and quality is so strong that for some respondents, the two words are almost synonymous.
Very high price	The second notion spontaneously associated with luxury, and almost as salient as the previous one, is that of a very high price. Such a perception is established either on the basis of the absolute value of the price or, more frequently, by comparison with non-luxury alternatives.
Scarcity and uniqueness	The third concept associated with luxury is that of scarcity. Scarcity is closely associated with the perceived excellent quality and high prices associated with luxury goods.
Aesthetics and polysensuality	The fourth aspect of luxury involves a strong aesthetic appeal. And, according to many consumers, it should always be the case. At the extreme, luxury products become pieces of art which have to be recognized as such.
Ancestral heritage and personal history	The fifth notion associated with luxury is its anchoring in the past. In consumers' mind, to be luxurious, products and services must have a long history and their elaboration processes as well as consumption should respect tradition.
Superfluousness	Finally, the concept of luxury implies some perceived superfluousness or uselessness. Luxury products are not felt to be necessary for survival. It is in this sense that consumers as well as researchers oppose luxuries and necessities.

Source: Dubois B., Laurent G. & Czellar, S., 2001, Consumer Rapport to Luxury: Analyzing Complex and Ambivalent Attitudes. Les Cahiers de Recherche, 33(1)

Gradually the advent of a rising middle class and the increase in purchasing power allowed a greater share of individuals to progressively approach such a market. Recently, there has been a luxury 'democratization' due to the presence of *luxury excursionists*. This new customer segment was first introduced by Dubois and

[98] Tartaglia A., Marinozzi G., 2006, Il lusso…magia e marketing, Franco Angeli.

99 " *A good is defined as a luxury for a person if he spends a larger proportion of his income on it when his income rises*".
Frank R.H., 1991, in Microeconomics and behavior, McGraw-Hill, New York 1991.

100 Brioschi A., 2000, Comunicare il lusso, Università Luigi Bocconi.

[101] Dubois B., Laurent G. & Czellar, S., 2001, Consumer Rapport to Luxury: Analyzing Complex and Ambivalent Attitudes, Les Cahiers de Recherche, 33 (1).

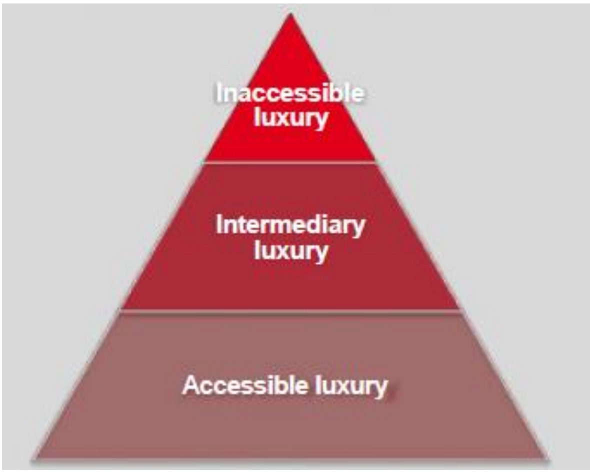
Laurent in 1996[102] and contains all of those individuals who do not possess the necessary resources to lead a luxurious lifestyle but can afford a unique or intermittent access to prestige goods.

Nowadays luxury is affordable to great minorities who contributed to the creation of the '*New Luxury'*, or luxury for the masses (purely an American phenomenon, but also extended to the European reality) which differs from traditional luxury by generating high volumes despite the high price[103]. This new approach revolutionized the concept of luxury and caused a shift from "ordinary consumption from extraordinary people" to "extraordinary consumption from ordinary people"[104].

The production of luxury items is now able to deal with millions of orders, while in the past was of superior craftsmanship and exclusively dedicated to the creation of a limited edition unique pieces.

In order to provide a greater understanding for such an abstract concept, in 1991, Danielle Alleres developed a theory assuming that luxury can be segmented into three different domains, based on the level of exclusivity of the goods and on which specific reference class they serve[105]. For simplicity, this theory is usually graphically represented as a pyramid.

Figure 3. The Alleres luxury pyramid



Source: Unicredit, February 2016, Luxury report.

At the top of the pyramid is positioned Inaccessible Luxury: this domain refers to goods of which there are a few pieces, made to measure, crafted with selected raw materials and distributed in a selective way at astronomical prices. These products cater to the wealthiest social class which is more willing to express social superiority through rare and exclusive goods. Luxury goods located in this category have the aim to keep the stylistic codes and the classic content of the brand alive.

At the second level of the pyramid there is *Intermediate Luxury*. Non customized goods belong to this category, adaptable to customer needs and selectively distributed at high prices. They cater to the middle class, economically weaker than the last, which owes its success to professional success rather than family inheritance (old money). This product category should aim to reaffirm the membership of a higher world,

[102] Dubois B. and Laurent G., 1996, The Functions of Luxury: a Situational Approach to Excursionism, Advances in Consumer Research Volume 23, eds. Kim P. Corfman K. P. and Lynch J.G. Jr.
[103] Fiske N., Silverstein J., 2003, Luxury for the masses, Harvard Business Review.
[104] Laurent G., Dubois B., 1996, The function of luxury: A situational approach to Excursionism, 23.
[105] Alleres D., 2012, Do consumers perceive three levels of luxury? A comparison of accessible, intermediate and inaccessible luxury brands, Journal of Brand Management, May 2012, Volume 19, Issue 7.

close to that of the social elite and their lifestyle. At the lowest level we find *Accessible Luxury*. Goods belonging to this category are produced and distributed on a larger scale, in which the connotation of luxury is provided more by the brand rather than by the uniqueness of the product. The primary objective of this last category is to differentiate itself from premium products, serving as the access key to the world of luxury brands.

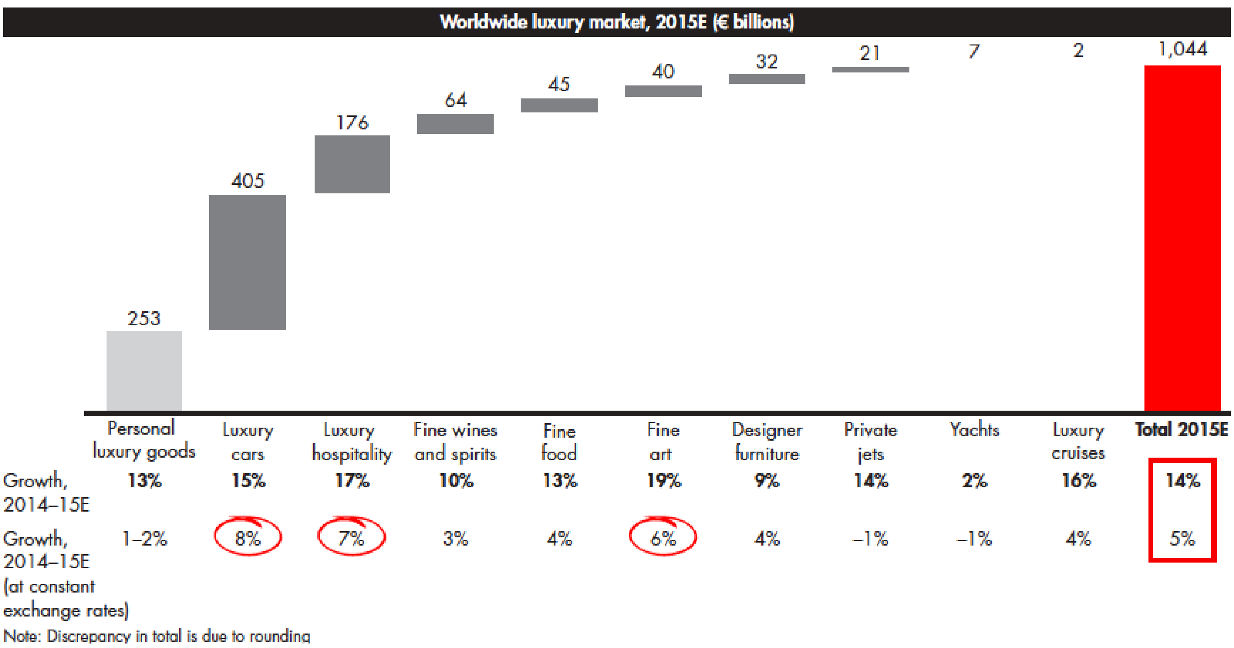
2.2 Global overview of the market and changing trends

According to 2015 edition of the Bain Luxury Study - published by Bain & Company for Fondazione Altagamma, the trade association of Italian luxury-goods manufacturers - the worldwide luxury industry exceeded € 1,000 billion euros in retail sales in 2015 (see Figure 4), with a growth of 5% at constant exchange rates (+14% at current exchange rates).

The overall luxury industry can be divided in ten different business segments:

1. luxury cars (approximately 39% of the luxury market);
2. personal luxury goods (24% of the luxury market);
3. luxury hospitality (17%);
4. fine wines and spirits (6%);
5. fine food (4,3%);
6. fine art (3,8%);
7. designer furniture (3%);
8. private jets (2%);
9. yachts (0,7%);
10. luxury cruises (0,2%).

Figure 4. Worldwide luxury market: retail sales, € billions



Source: Fondazione Altagamma, Bain & Company, Luxury goods worldwide market study, Fall – Winter, 2015.

In 2015 the growth of the luxury industry was led by luxury cars (+8% at constant exchange rates), hotels (+7%) and the arts market (+6%). Fine food and Designer furniture experienced a real growth of 4%, followed by wines and spirits (3%).

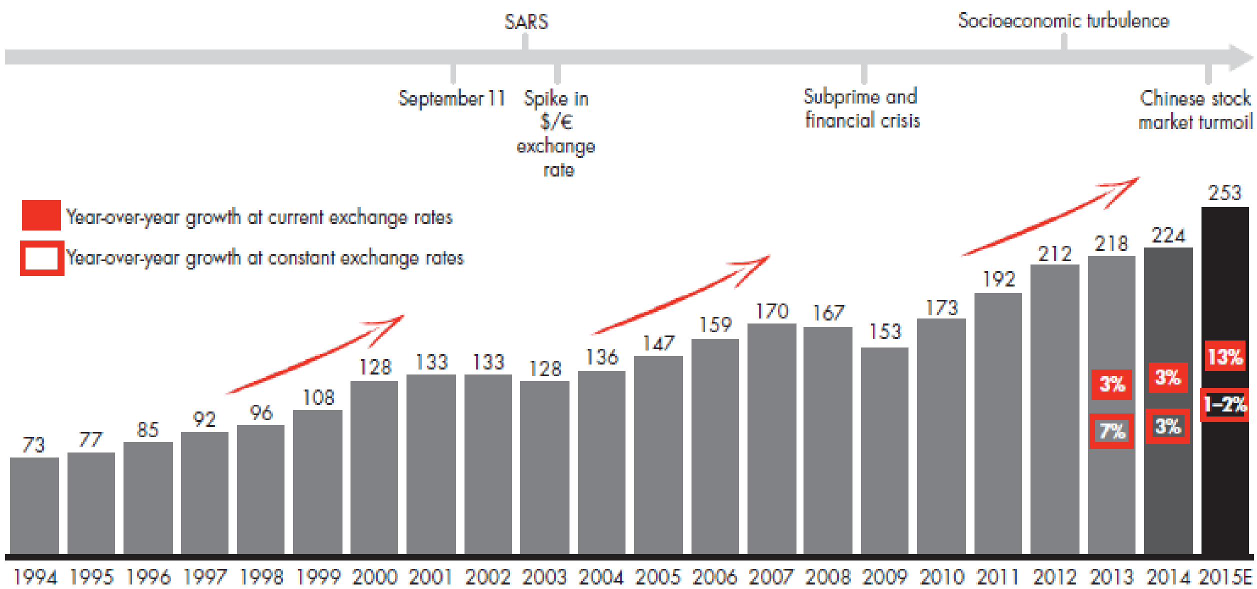
The three biggest segments constitute the 80% of the total market and are:

1. **Personal Luxury**. This category consists of all commodities concerning personal care such as fashion, accessories, jewels, watches, leather goods, fragrances and cosmetics.
2. **Luxury Cars and Yachts**. In this category we find luxury means of transportation such as luxury cars and boats.
3. **Experiential Luxury**. This segment includes hotels and restaurants.

The focus of my analysis will be on the segment of personal luxury goods, which represents the core business of the entire luxury market and accounts for more than €250 billion in 2015 (see Figure 5). It is the second largest segment of the luxury market (24% of the overall market), after luxury cars which account for 39% of the market. The value of this segment has more than tripled over the past 20 years, from € 73 billion in 1994 to € 253 billion in 2015. Furthermore, the sector has showed a strong resilience to the crisis occurred in 2008 and has experienced a 13% growth in 2014 at current exchange rates, while real economic growth has slackened to only 1%–2% (see Figure 5). According to Bain Luxury Study, the slowdown in the last years confirms a "new normal" (and lower) level of sales growth in this segment[106].

The growth of the personal luxury goods market was favored by global currency fluctuations and increasing purchases by "borderless consumers" (consumers without geographical barriers).

Figure 5. Global personal luxury goods segment, 1994 -2015, € billions.



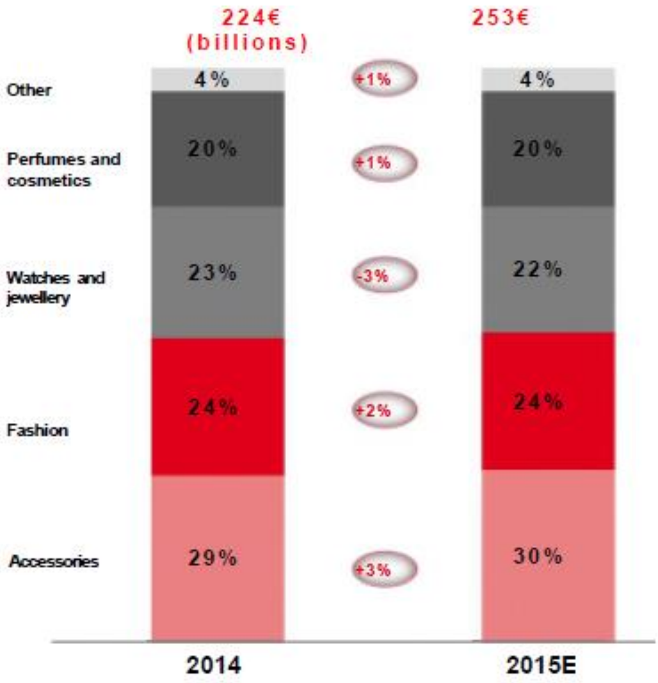
Source: Fondazione Altagamma, Bain & Company, Luxury goods worldwide market study, Fall – Winter, 2015.

106 Fondazione Altagamma, Bain & Company, 2015, Luxury goods worldwide market study.

Within the segment of personal luxury goods, accessories have become the largest segment (30% of the total market; see Figure 6), with higher growth with respect to all other segments, amounting to 3% at constant exchange rates in 2015 (on annual basis). Within the accessories category, shoes are becoming a status symbol of accessible luxury; this is highlighted by the highest growth in the last three years (+4% at constant exchange rates in 2015) with respect to the entire leather goods category (2%).

The second largest segment is fashion, which constitutes one fourth of the entire personal luxury goods market and register a yearly growth of 2% in 2015. "Jewelry and watch" (this category contracted by 3% in 2015) and "perfumes and cosmetics" represent respectively 22% and 20% of the overall market. Jewelry shows the highest growth rate of +6% due to the fact that is considered a safe haven from consumers from all around the world. On the other hand watches registered a reduction of 6% at constant exchange rates, due to the decreasing sales in Asia for excessive stock and a contraction in the overall store network[107]. Forecasts for 2016 signal a moderate growth for all different sectors[108].

Figure 6. Luxury personal goods, categories, 2014-2015E (market share, growth at constant exchange rates)



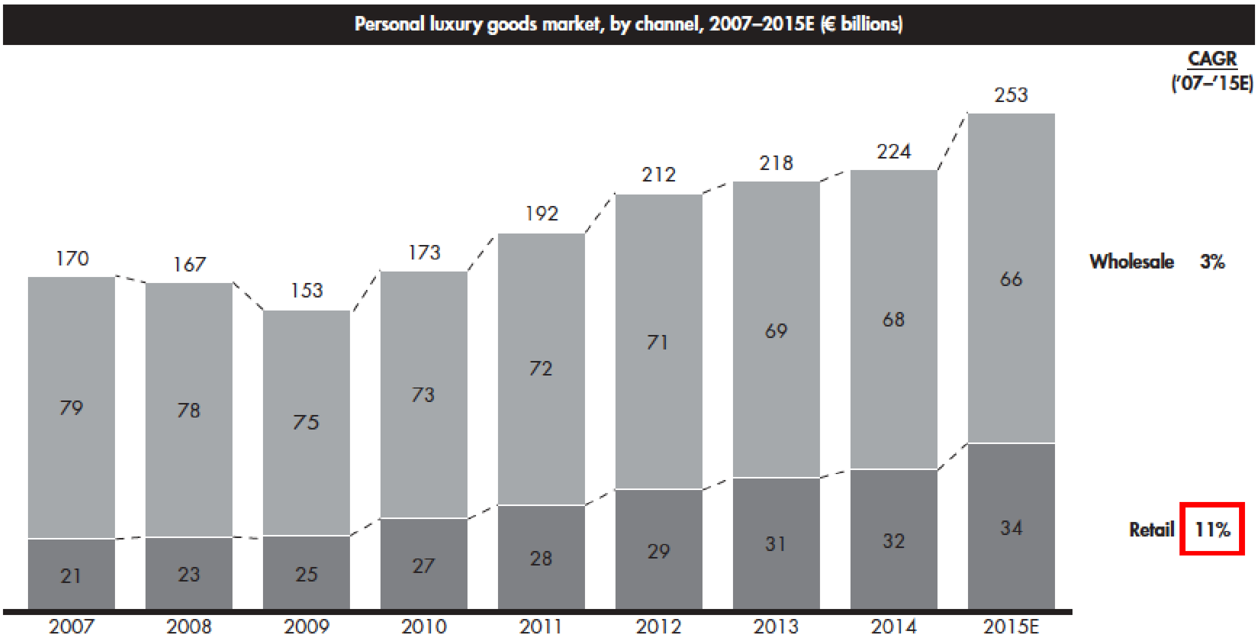
Source: Fondazione Altagamma, Bain & Company, Luxury goods worldwide market study, Fall – Winter, 2015.

Regarding distribution, in 2015 wholesale remained the strongest selling channel, with a share of 66% (see Figure 7). However, retail continued to gain ground against the wholesale market (share of 34%), growing at a rate of 20% (600 new directly operated store, DOS, opened worldwide in 2015 compared to 750 in 2014; slight slowdown in new DOS opening, especially in emerging markets) with respect to the 10% of the

[107] Fondazione Altagamma, Bain & Company, 2015, Luxury goods worldwide market study.
[108] Unicredit, 2016, Luxury Report.

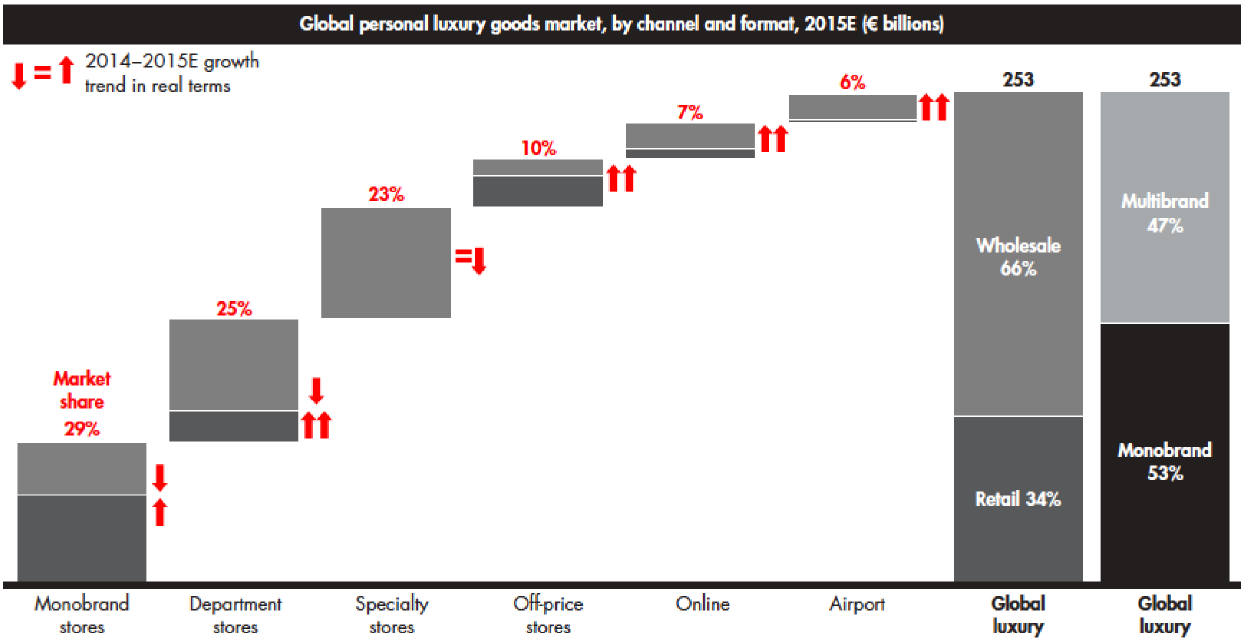
former[109]. This is the outcome of the ongoing "retailization" of luxury, with the conversion of franchised locations in company-owned store or joint-ventures.

Figure 7. Personal luxury goods market, by channel,2007-2015E (€ billions).



Source: Fondazione Altagamma, Bain & Company, Luxury goods worldwide market study, Fall – Winter, 2015.

Figure 8. Global personal luxury goods market, by channel and format, 2015E (€ billions)



Source: Fondazione Altagamma, Bain & Company, Luxury goods worldwide market study, Fall – Winter, 2015.

Mono-brand distribution remains the prevailing distribution channel, with a share of 53% (multi-brand has a share of 47%). Retail and mono-brand stores continued to be the best performing formats (see Figure 8).

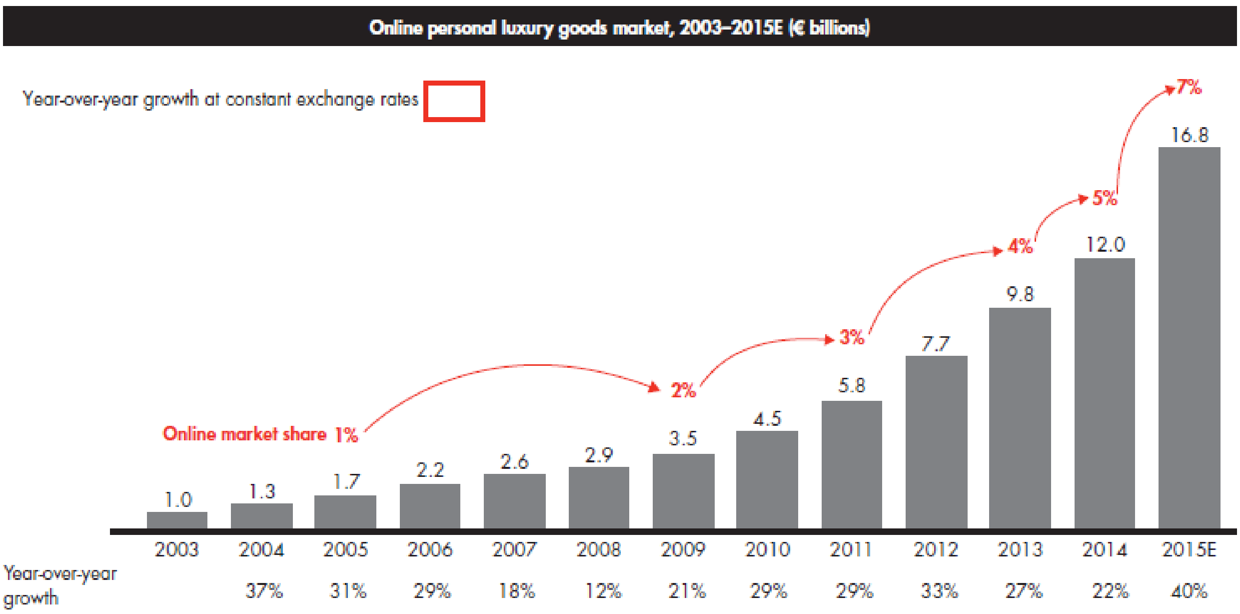
[109] Unicredit, 2016, Luxury Report.

Travel retail within airports is gaining increasing importance, due to the higher presence of globe trotters: in fact, in 2015 this business amounted to € 14 billion and represented 6% of the total luxury personal goods sales (see Figure 8). Here the commodities more frequently purchased are cosmetics and those concerning personal care (75% of total travel retail sales), followed by apparel and accessories and hard luxury accounting for 13% and 10% respectively. Asian and Japanese markets represent the highest proportion of sales within airports.

Over the past several years the rise of social networking sites and mobile application has radically revolutionized both the way in which the brand communicates with its consumer base and the purchasing behavior of consumers themselves. Traditionally luxury companies felt obliged to isolate their products from the mass market; however, the rise of new media changed the competitive landscape. In fact, according to the Altagamma and Bain luxury report it emerges that online channels have experienced an increasing double digit growth in 2015, representing 7% of the entire market and worth € 16,8 billion (see Figure 9).[110] The online channel is particularly strong in the Americas, especially in the accessories and fashion categories.

The advent of the internet and e-commerce has caused several changes in consumers' buying behavior. A phenomenon which has significantly spread in the past years for what concerns luxury goods is known as *research online and purchase offline* (**ROPO**). This practice, also known as *Online-to-Store*, involves gathering information and evaluating options for a possible purchase online and then make the actual purchase in the bricks and mortar store. Furthermore, the increased usage of technological devices has revolutionized customer relationships, providing individuals with numerous continuous-access touch-points and real time information.

Figure 9. Online personal luxury goods market, 2003-2015E (€ billions)



Source: Fondazione Altagamma, Bain & Company, Luxury goods worldwide market study, Fall – Winter, 2015.

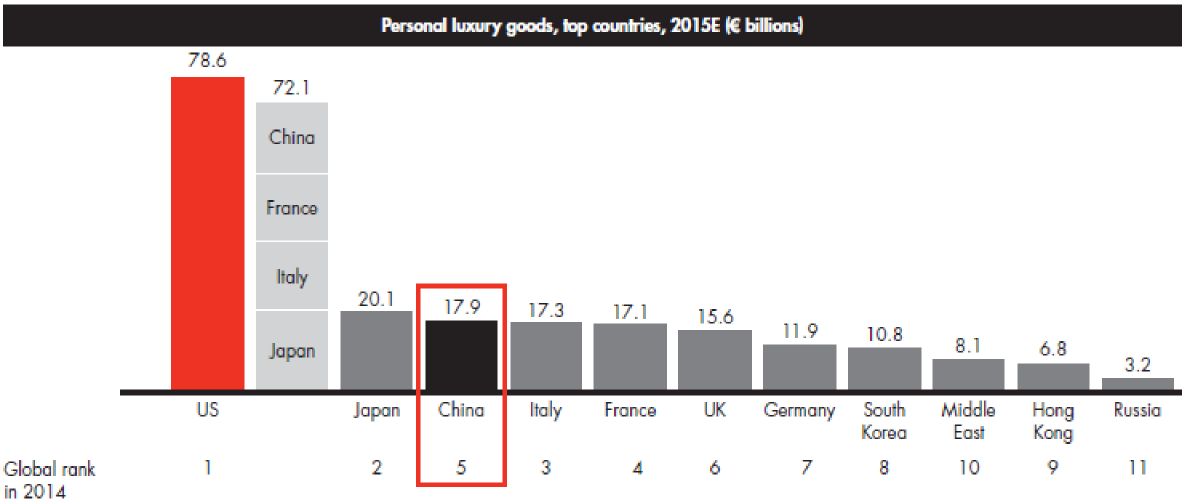
[110] Altagamma, Bain & Company, 2015, Luxury goods worldwide market study.

Forecasts for upcoming years suggest that the penetration of e-commerce in the fashion and luxury sector will continue to increase. Most of online sales are expected to be achieved through mobile commerce, confirming the trend to renew distribution channels going towards a digital solution.

For what concerns geographical areas, in 2015 the US, while not delivering a real growth, became the largest global personal luxury goods market with 78,6 billion euros (see Figure 10), primarily thanks to the "super dollar". It accounts for more than Japan, China, Italy and France taken together (72,1 billion euros). China has reached the global luxury podium, becoming the third largest market in 2015, after the US and Japan. The strong growth of emerging markets caused a significant redistribution of global GDP shares from established markets to emerging markets.

Italy and France - the countries which produce to a greater extent luxury goods in Europe - has lost rank positions in 2015, shifting respectively to the 4th and 5th position.

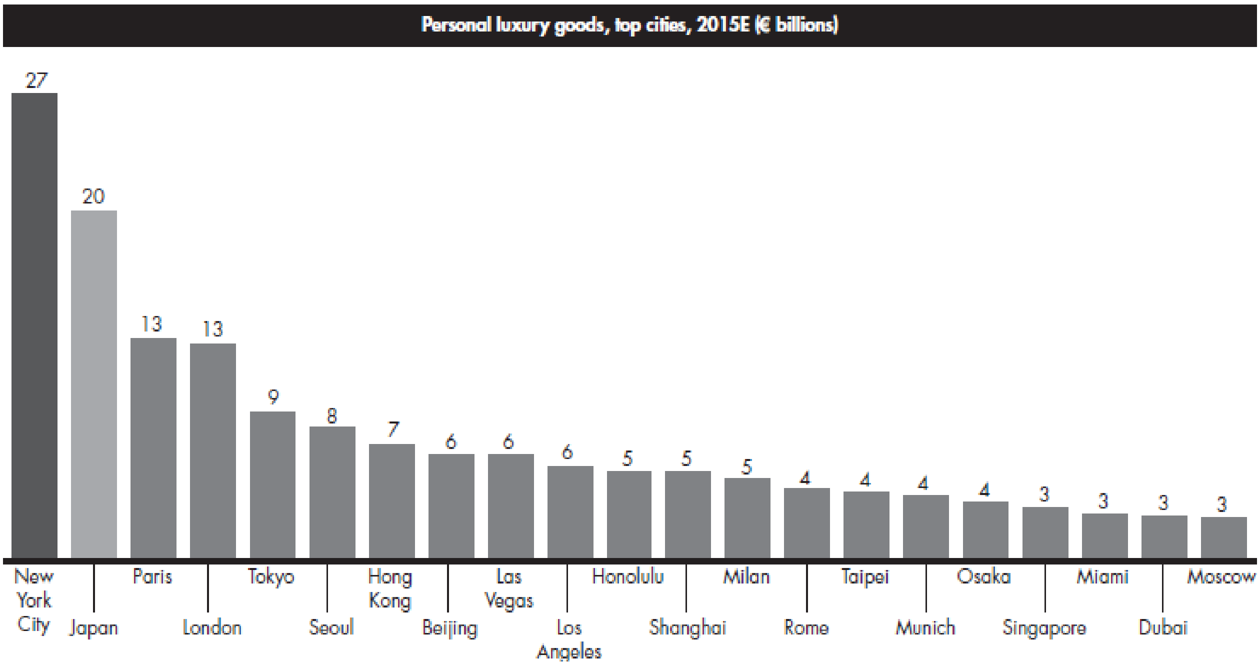
Figure 10. Personal luxury goods, top countries (€ billions)



Source: Fondazione Altagamma, Bain & Company, Luxury goods worldwide market study, Fall – Winter, 2015.

Regarding the top cities in personal luxury goods sales (see Figure 11), New York holds a primary position with 27 billion euros, followed by Paris and London (13 billions each). As a matter of fact, luxury good purchased in New York City are higher than those across all Japan (20 billions). The two Italian cities in the top-20 are Milan (12th position) and Rome (14th position) with respectively 5 and 4 billion euros.

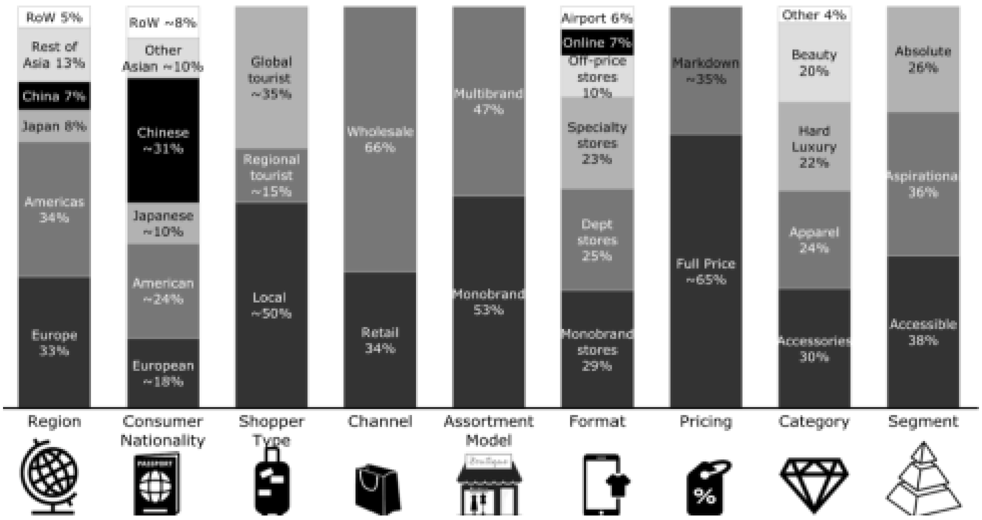
Figure 11. Personal luxury goods, top cities, 2015E (e billions)



Source: Fondazione Altagamma, Bain & Company, Luxury goods worldwide market study, Fall – Winter, 2015.

All the characteristics of the personal luxury goods industry are summarized in the following chart (see Figure 12): for geographical region, consumer nationality, shopper, channel, assortment model, format, pricing, category and segment.

Figure 12. The 2015 personal luxury goods market at a glance, 2015E



Source: Fondazione Altagamma, Bain & Company, Luxury goods worldwide market study, Fall – Winter, 2015.

Chinese consumers play a key role in the growth of luxury spending worldwide: they account for 31% of the total luxury purchases (Asian people account for more than 50%), followed by Americans (24%) and Europeans (18%). The dominance of Asian consumers is due to the advent of a new consumer segment, the so called "*new money consumers*". The growth of emerging markets translates in the rise of a new middle class consumers segment, known as "new money", with a strong purchasing power and prone to the consumption of aspirational products.[111]

People from all around the world who acquires luxury goods appears to be extremely variegated in terms of tastes, approaches and frequency of the purchase, even within the same country. The enthusiasm and eagerness for luxury products can be noticed primarily in emerging markets, such as China, while in established markets, like Europe, England and the United States there is a tendency to be less impulsive.

Consumers of luxury products have traditionally been classified into five different socio-economical groups: i) the ***aspirational mass market*** (not big spenders if taken individually, but significant when taken as a group (30% of the total luxury sales); the consumers of this segment are characterized by average income but aspire to have an above-average lifestyle); ii) the ***rising middle class*** (coming from a middle class background and having well-paying jobs, represents one fourth of global luxury sales); iii) the ***new money households*** (they have at least $1 million in bankable assets and earned their wealth through investment and business activities; this segment represents one third of luxury sales); iv) the ***old money households*** (individuals who inherited their wealth; accounting for 7% of sales) and v) the ***beyond money households*** (these consumers – that represent 5% of total luxury sales - are similar to the old money households but they are classified apart for their completely "indifference to status"; they usually avoid ostentatious display of wealth and reaffirm their status through the disdain for conspicuous brands)[112].

The last three groups have historically been the most important ones for this market. In the categories of new money and old money households we can find **High Net Worth Individuals** (**HNWIs**), while in the last faction (the *beyond money households*) are located **Ultra High Net Worth Individuals**.

Figure 13. The least established segments spend the most on luxury

Source: Dirk Ziems, Concept M (http://conceptm.eu); BCG analysis
¹Brazil; Europe,China, Japan, Russia, and the United States.
²Includes only spending on traditional categories.

The High Net Worth Individuals have been growing throughout 2014 in number and patrimony, even though at a slower pace with respect to previous years. The region of Asia-Pacific significantly contributed to the growing population of HNWIs, with an increase of 8%, even surpassing North America as the region with

[111] Unicredit, 2016, Luxury Report.
[112] Bellaiche J., Mei-Pochtler A., Hanisch D., 2010, The new world of luxury: caught between growing momentum and lasting change, Boston Consulting Group

the highest number of wealthy individuals with financial wealth greater than a million. Nevertheless, North America continues to have the highest share of investible assets with US$ 16,2 billion, with respect to Asia Pacific with 15,8 billion and 13 billion for Europe[113].

Nowadays, though, the traditional boundaries are blurring and consumers of luxury goods do not belong exclusively to an elite market. This, certainly, caused a change in strategies for enterprises in order to be able to appeal to a larger group of consumers.

2.3 Industry characteristics and success factors

2.3.1 Industry characteristics

As seen in the previous paragraphs, the luxury industry is a very peculiar industry, mostly due to the fact that it is characterized by intangibility more than any other sector. As stated by Belinda Earl, CEO of Jaeger (a United Kingdom-based luxury brand) from 2004 to 2011, "*None of us are in the business of selling necessities; luxury is the business of creating and satisfying desires*". Luxury always operates as social distinction: it's an excess, it's an eccentricity. Thus, its products are a controlled scarcity, accessible only to the happy few belonging to the "elite market".

The specificity of the luxury industry is linked, on one side, to the strong relevance of creative talent needed for creating a successful luxury brand and, on the other side, to the remarkable differences in the way of management of a luxury brand with a worldwide market. Thus, this industry can be considered peculiar compared to other sectors (non-luxury sectors) and is defined by three relevant characteristics[114], which are:

1. *Firm size*. In the luxury industry firms are usually small-to medium sized enterprises with an impressive reputation. This is due to strong brand awareness, as consumers have a genuine interest in luxury and fashion brands. In the luxury world, it seems that size does not matter for the single luxury brand. In this industry, economies of scales are reached by big conglomerates through large brand portfolios, made up of many small individual companies. LVMH, the luxury-goods giant has a portfolio of more than sixty powerful brands, with total annual revenues of 30 billion in 2014. This means that each LVMH brand would have, on average, annual revenues for approximately 500 million, remarkably less (from ten to twenty times less, according to Chevalier and Mazzalovo G. in Luxury Brand Management[115]) than other brands such as Gap or Zara.

   The fact that the industry is made of small and medium sized enterprises has an obvious consequence: a limited number of workers will be employed. Some firms in the industry are very small and they may just consist of a design studio in charge to design products and monitor trends. In many cases these enterprises subcontract all of the other activities to third parties. Subcontracting

[113] Unicredit, Luxury report
[114] Chevalier M., Mazzalovo G., Luxury Brand Management: A world of Privilege, 2nd edition.
115 Chevalier M., Mazzalovo G., Luxury Brand Management: A world of Privilege, 2nd edition.

activities elsewhere is a very common choice in this industry which may apply not only to small independent players, but also to brands belonging to one of the big conglomerates. To subcontract production activities (that are carefully controlled by the luxury company) is the second very peculiar characteristic of luxury firms (i.e. many components of the luxury watches are made by many different companies but they are assembled internally).

2. *Financial Structure*. A financial characteristic of all luxury enterprises is the very high breakeven to which they are subject. In an average sector, the breakeven point is a function of fixed costs and manufacturing investments. In the luxury market all brands, no matter how small, have to make high investments in any phase of the value chain in order to succeed, thus, ending up with a very high break even. Every brand must be present worldwide and guarantee top quality in any stage, from the production process to the sales process (e.g. product; exposition in store; packaging, etc). As soon as the brand is able to achieve sales above the breakeven level, a large part of the margins becomes profits since margins are very high.

   Another industry's characteristic regards the capability of many luxury companies that have been losing money for many years to survive as a part of the luxury group - thanks to its economic and financial strength - or as a diversified activity of another industrial firm. In any other industrial sector, a company losing money has to exit rapidly the market or merge with its competitors. The reasons why capable executives of luxury groups can withstand to incur in losses for a prolonged period of time are two:
   - firstly, the value of the brand and brand awareness (despite losing money for more than ten years, the Guy Laroche brand remains strongly attractive to consumers);
   - second, luxury groups are usually so profitable and successful that they can compensate for years of losses.
3. *Time frame*. In the luxury industry the most important strategic decisions have not a short-term impact for it takes much time to build a successful brand or to modify the image of a brand because of its specific identity in the mind of consumers. In the luxury world, launches require longer preparations and many more investments compared to other sectors. As a matter of fact, the lead time for a launch can be from eighteen months to two years[116] (i.e. fragrances, watches, etc..). For major launches, in the first year, it is not unusual to spend on advertising and promotion a sum equal to the forecasted first-year sales. On average, every launch takes three or four years to start making money.

   The time frame is different for each product of a specific sector. For example, in the watch business, the launch of a product have to be completed in time for the Geneva or Basel watch and jewelry fairs at the end of February or beginning of March. Otherwise, the launch should be postponed to the following year.

[116] Chevalier M., Mazzalovo G., Luxury Brand Management: A world of Privilege, 2nd edition.

The fashion cycle lasts eighteen months, following the different phases illustrated in Figure 14 which start in September of the year t-1 with the fabric commitments and end in January-February of the year t+1 with the bargain sale. This time frame obliges the brands to make plans a long time ahead.

Figure 14. Fashion Cycle for a Fall Winter Collection

Exclusive fabric commitments	September–October, year $t-1$
Development of prototypes and matching with fabrics	September–October, year $t-1$, February, year t
Fashion show	February–March, year t
Order-taking from multibrand stores	March, year t
Delivery to the stores	July, year t
Sale at full price	September–December, year t
Bargain sale	January–February, year $t+1$

Source: Chevalier M., Mazzalovo G., Luxury Brand Management: A world of Privilege, 2nd edition.

Summing up, the average luxury-goods firm is usually small-medium sized with a very limited staff. Another industry's characteristic is the tendency to subcontract production activities. This business is characterized by a very high breakeven point but as soon as the brand is able to achieve sales above the breakeven level, a large part of the margins become profits.

2.3.2 Industry success factors

As already mentioned above, the luxury goods industry has specific characteristics with respect to other sectors. This can be easily understood with the so called "paradox of luxury goods marketing" (see Table 2), because as stated by Professor Bernard Dubois "*to achieve success in this field, it was necessary to do exactly the opposite of what was taught in traditional marketing lessons*"[117]. In other words, in the luxury market price should be high as well as cost and distribution should be limited to create a well-controlled scarcity.

Figure 15. The Paradox of Luxury-Goods Marketing

High price
High cost
Craftsmanship
Limited distribution
Low promotional activity
Advertising with no sophisticated copy strategy

Source: Bernard Dubois, 1998, L'art du Marketing, Village Mondial, Paris.

In order to be successful within this business, enterprises and brands must possess these three key elements.

[117] Dubois ., 1998, L'art du Marketing, Village Mondial, Paris.

1. *The need for a strong name*. Most luxury brands start by taking the name of a legendary figure which can be either the founder, the craftsman or designer, to which is associated the brand identity. To develop a fully-fledged business, thus not limiting it to the crafts of the founder, is crucial to diversify and enlarge the product lines to increase sales volume. The act of moving from one product category to another is known with the term of *'brand extension'*. This is an extremely delicate issue since major investments and efforts are needed to emphasize coherence and style for the new product line to be consistent and appropriate for the existing brand. Furthermore, consumers will need time to adapt and accept the new product line, so the overall acceptance process will require some time.
2. *Identifiable products*. When it comes to luxury goods, the design and craftsmanship must be very easily identifiable, whatever the model. When purchasing a luxury product, due to the premium price, certain assumptions must be met: the product must be of top quality, handcrafted and perfectly prepared for the individual purchaser, while the service should be excellent and the consumer experience unique.

   Aesthetic codes and coherence across the entire product range are mandatory for each brand. Furthermore, design should be a priority for every luxury product. While this is immediate for certain segments of the industry, such as fashion, for other it is not. For example, perfumes are usually associated with scent, whereas the creation of the product comes from the collaboration of two creative teams: one responsible for the scent of the fragrance and the other one for the design of the bottle.
3. *Social and cultural environment*. Luxury products must act as a cultural mirror, thus, it is crucial for brands to stay in touch with changing social trends to be successful. Being able to keep up with new trends is the reason why some brands developed very quickly at a time and subsequently underwent a rapid decline. This is simply the result of a product that does not keep up with changing times, and not the result of an ineffective management and marketing.

2.4 The consolidation jungle: the key players

2.4.1 Industry structure

At first glance this industry is considered to be an oligopoly dominated by the presence of a few large conglomerates which govern the overall market with no space for the small independent players.

In an increasingly challenging and globalized luxury environment, most of the world's leaders brands belong to one of the "big four" luxury conglomerates: LVMH, Kering, Richemont and Swatch. As a matter of fact, the luxury market is highly concentrated: according to the Deloitte Luxury Report[118], the economic concentration of the top 10 luxury goods companies is equal to more than 50% of the market. More

[118] Deloitte, 2014, Global power of luxury goods.

precisely, the luxury goods sales of the top 10 companies account for around 55% of the overall sales of the seventy-five giants in the market ($172 billion).

Within the Top 10 luxury companies, three are conglomerates operating in multiple luxury categories with multiple luxury brands (LVMH, Kering and Richemont); two are jewelry and watch companies (Swatch and Rolex); two are cosmetic and fragrance companies; two are apparel companies; one is an accessories company[119].

France and Switzerland dominate the market, having respectively three and two companies of the Top 10. For the ten largest companies, profit margins were higher than in 2013 (13.2%), outperforming the top 100 by 1.8 percentage point. Half of the group achieved double-digit net profit margins[120].

The fashion market is more diversified than the luxury one: partly owned by large luxury groups and partly still independent under the control of the founder or his family.

We can subdivide the players of the luxury industry into two different categories: one with diversified global conglomerates and the other made of independent players. In the latter group, many of the companies are family-controlled such as Prada, Ferragamo, Armani in the Italian market.

Concerning the product sector analysis of the top 100 luxury companies[121] (see Figure 16), the largest number of companies are concentrated in the apparel & footwear sector (36% share of top 100 companies), which represents a share of the top 100 luxury good sales equal to 18.4%. These firms are characterized by a smaller size. Half of the apparel and footwear firms are based in Italy.

Figure 16. Product sector profiles

Product sector profiles

	Number of companies	Average luxury goods size (US$m)	Share of top 100 companies	Share of top 100 luxury goods sales
Apparel & footwear	36	$1,095	36.0%	18.4%
Bags & accessories	12	$1,311	12.0%	7.3%
Cosmetics & fragrances	11	$3,126	11.0%	16.1%
Jewelry & watches	31	$1,818	31.0%	26.3%
Multiple LG categories	10	$6,832	10.0%	31.9%
Top 100	100	$2,142	100.0%	100.0%

Source: Deloitte, 2015, Global Powers of Luxury goods.
Note: A company is assigned to one of the four specific products sectors if a high percentage of its luxury goods sales are derived form that product sector. Multiple luxury goods (LG) companies are those with substantial sales in more than one of the luxury goods product sectors.

[119] Deloitte, 2016, Global power of luxury goods. The Report analyzes performance by five luxury goods product sectors: Apparel & Footwear, Bags & Accessories, Cosmetics & Fragrances, Jewelry & Watches, Multiple Luxury Goods. A company is assigned to one of the four specific product sectors if a high percentage of its luxury goods sales are derived from that product sector. Multiple luxury goods (LG) companies are those with substantial sales in more than one of the luxury goods product sectors.
[120] Deloitte, 2016, Global power of luxury goods.
[121] Deloitte, 2015, Global Power of Luxury Goods.

More broadly, Europe still dominates the fashion industry, with only six companies based in other geographical areas.

The jewelry and watch sector have the second largest number of companies in the Top 100 (31%), with a slightly smaller than average size ($1.8 billion). Cosmetics and fragrances companies, on the other hand, are larger in size than the Top 100 on average. The multiple luxury goods (LG) companies are only ten but they account for around 32% of the share of the top 100 luxury good sales. The average size of these companies is the largest one, more than three times the average Top 100 companies.

Regarding country profiles, French companies in the Top 100 hold the highest sales share of the market (23.2%). Italy, with twenty-nine enterprises, is the country which is most represented, despite the smaller dimensions of its enterprises (see Figure 17). In terms of firm's number, this country alone accounts for around one third of the overall market; while in terms of luxury goods sales, the weight of Italian firms is much lower (16.5%). In fact, the Italian luxury companies are remarkably smaller than the French and Swiss ones: the average luxury company size in Italy according to the Deloitte Report of global power of luxury goods, is equal to around $1.2 billion compared to around $4,5 billion in France and $2.9 billion in Switzerland (see figure below).

Figure 17. Country profile (companies are assigned to a country based on their headquarters' location)

Country profiles

	Number of companies	Average luxury goods size (US$mil)	Share of top 100 companies	Share of top 100 luxury goods sales
China/Hong Kong	7	$3,455	7.0%	11.3%
France	11	$4,513	11.0%	23.2%
Italy	29	$1,222	29.0%	16.5%
Spain	5	$637	5.0%	1.5%
Switzerland	11	$2,882	11.0%	14.8%
United Kingdom	6	$980	6.0%	2.7%
United States	15	$2,927	15.0%	20.5%
Other countries	16	$1,268	16.0%	9.5%
Top 100	100	$2,142	100.0%	100.0%

Source: Deloitte, 2015, Global Powers of Luxury goods 2015.
Note: Results reflected Top 100 retailers headquartered in each country.

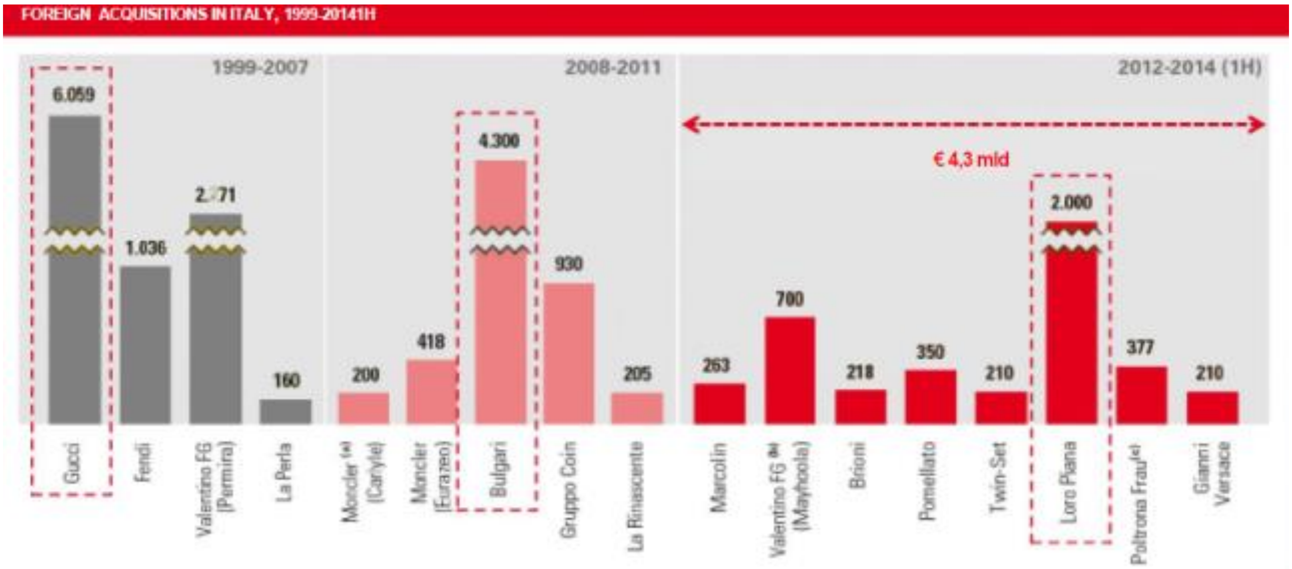
The 'Made in Italy' luxury brand reputation - thanks to the prolific creative talent along with the tradition of high quality and heritage - is strongest in the fashion sector: two-thirds of Italian companies in the Top 100 operate in the apparel & footwear sector.

In Italy the industry is highly fragmented: therefore, many Italian firms are small or medium sized companies, family-owned businesses, which tend to be more likely prey rather than predators in the international mergers & acquisitions landscape.

As illustrated in Figure 18, in the 1999-2007 period most of the famous Italian luxury brands were acquired by large foreign groups, although some important independent players continue to exist to this day. In the last 15 years the largest foreign acquisition of luxury companies in Italy amounted to 20 billion euros, of which 4,3 billions concentrated in the last two years. Among the biggest acquisitions, it is worth mentioning the three following operations:

1. the acquisition of Gucci from the French group PPR, now named Kering, made in 2004 for an amount of di 6.1 billion euros;
2. in 2011 the French luxury giant LVMH bought the 100% of Bulgari company for a value of 4,3 billion euros;
3. more recently, the same luxury conglomerate (LVMH) acquired 80% of Loro Piana for an amount of 2 billion euros.

Figure 18. Foreign acquisitions of luxury companies in Italy



Source: KPMG, 2014, Le acquisizioni di investitori esteri in Italia.

In 2013 there were fourteen newcomers in the Top 75 luxury companies, compared to 2012[122]. The largest new companies which entered the top 50 were all jewelry and watch companies and were based in Asian countries (especially China). The five new entrants located in between positions 50 to 75 were all European fashion-related companies. In 2014 there were nine new entrants in the Top 100[123]: five apparel and footwear companies; three jewelry and watches companies and one cosmetics and fragrances company.

122 Deloitte, 2015, Global Power of Luxury Goods.
123 Deloitte, 2016, Global Power of Luxury Goods

2.4.2 The four big conglomerates

The most important players in the luxury business are four big corporations, known in the industry as the "*big four*" which are: the Moet Hennessy Louis Vuitton Group (LVMH), the Kering Group, the Richemont Group, and the Swatch Group. According to Jonas Hoffman and Laurent Lecamp, as of 2015, these diversified groups own more than 100 brands, are maintaining a constant pace of acquisitions, and continue to rely on vertical integration to secure supplies. This pace of vertical integration has important consequences for independent players, since the large groups deprive them of possible suppliers. This is the reason why most independent players are struggling to survive and are faced with one of two possibilities: end up being acquired or going out of business.[124]

LVMH

The largest global conglomerate which dominates the luxury market is the French giant LVMH. The Moet Hennessy Louis Vuitton (LVMH) group is the worldwide leader of the industry, owning more than sixty exceptional brands, and is present in all five major sectors of the luxury market: i) Wines & Spirits, ii) Fashion & Leather Goods, iii) Perfumes & Cosmetics, iv) Watches & Jewelry and v) Selective Retailing. The Group was founded in 1987 as a result of the merger between Louis Vuitton (LV), specialized in leather goods, and Moet Hennessy, a leader in the wine and spirit sector. The Group has a balanced and attractive portfolio. Among the most famous luxury personal goods brands there are: Louis Vuitton, Christian Dior, Fendi, Bulgari, Loro Piana, Emilio Pucci, Acqua di Parma, Donna Karan, Loewe, Marc Jacobs, TAG Heuer.

Figure 19. The House of Arnault*

Source: Wetlaufer S,, 2009, The perfect paradox of star brand: an interview with Bernard Arnault of LVMH, Harvard Business Review.

** Note: the figure refers to the year 2009. The more recent acquisitions – such as Bulgari and Loro Piana - are missing from the table.*

[124] J. Hoffman, L. Lecamp, 2015, Independent Luxury: the four innovation strategies to endure in the consolidation jungle, Palgrave Macmillan.

LVMH is the only luxury player that has two strong category legs: a leader position in the wine and spirit sector and an extremely strong position in leather goods with the Louis Vuitton brand. These two segments – the "star" and future "cash cow" in the portfolio – account for the 80% of the Group's operating profits. In these two sectors LVMH group leads in terms of market share and acts as industry consolidator.

Perfumes & cosmetics, selective retailing and watches & jewelry are the "question marks" of the group's portfolio[125]. In these segments, LVMH is making a bet for the future: value creation should come from faster organic growth as well as from focused merger and acquisitions, leading, in time, to improving operating profits and cash performance.[126]

In 2015 the Group was the leader of the industry, owning seventy different houses, 3,860 stores employing 125,000 individuals and with a turnover of 35.7 billion € (see Table 3).

Table 3. LVMH, Revenues by business segment

REVENUE BY BUSINESS GROUP (EUR millions)	2015	Reported growth	Organic growth(1)
Wines & Spirits	4,603	+16%	+6%
Fashion & Leather Goods	12,369	+14%	+4%
Perfumes & Cosmetics	4,517	+15%	+7%
Watches & Jewelry	3,308	+19%	+8%
Selective Retailing	11,233	+18%	+5%
Other activities and eliminations	(366)	-	-
TOTAL LVMH	**35,664**	**+16%**	**+6%**

(1) At constant structure and exchange rates.

Source: LVMH, 2015, Annual Report.

From a strategic perspective, LVMH has developed an operating model secured on six pillars[127]:

1. **Decentralized organization**: the Group's structure and operating principles ensure that the Houses within their portfolio are both autonomous and responsive;
2. **External and organic growth**: LVMH expanded over the last years in two ways, acting as a market consolidator and enriching its portfolio with many brand acquisitions and through organic growth of its houses;
3. **Vertical Integration**: the Group aims at fostering excellence both upstream and downstream, strengthening control over the different phases in the value chain;
4. **Creating synergies**: by sharing resources on a Group scale, LVMH leverages on its Houses in order to create synergies, always respecting individual entities;

125 Bernstein Research, 2009, LVMH: King of the Luxury Jungle.
126 Bernstein Research, 2009, LVMH: King of the Luxury Jungle.
127 2015, LVMH Presentation

5. **Balance across business segments and geographies:** the LVMH portfolio is well-balanced both across its business activities and geographic footprint. This balance makes the Group more resilient to future economic shocks.
6. **Sustain savoir-faire**: in order to preserve their heritage and excellence over time, LVMH and its Houses have developed some initiatives to transmit savoir-faire regarding craftsmanship and creative métiers to younger generations.

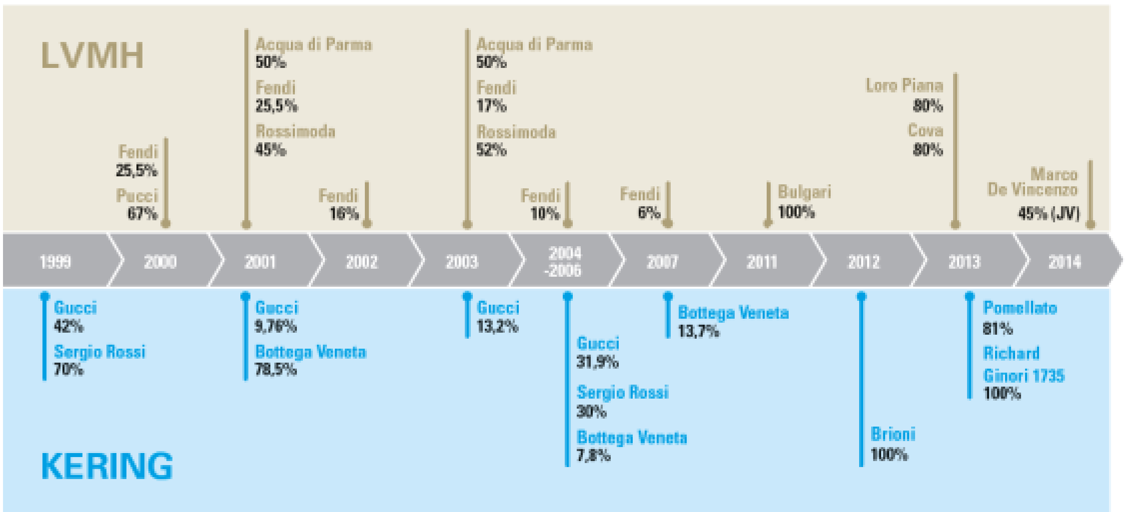
Kering

Kering SA, formerly known as Pinault Printemps Redoute (PPR) Group, is a luxury global conglomerate with headquarters in Paris, with €11.6 billion of consolidated revenues[128] and 34,697 employees working in 62 countries in which the company operates.

The group entered into the luxury sector in 1999 with the acquisition of a 42% stake in the Gucci Group. More acquisitions followed in order to build a stronger luxury identity, such as the ones of Yves Saint Laurent and Sergio Rossi. In 2001 the Gucci Group also bought Balenciaga and Bottega Veneta and signed partnerships with Alexander McQueen and Stella McCartney. From 2001 until 2004, PPR progressively reinforced its capital participation in the Gucci Group. Moreover, the Group consolidated its position in the Sports and Lifestyle sector in 2007, by purchasing 62.7% of shares of Puma.

The main objectives of the Group in the past years have been mainly two: the organic growth of each distinct brand and expanding the group's portfolio through targeted acquisitions. Kering aggressively carried out M&A deals and developed into a conglomerate company which focus on apparel and accessories segments. Kering and LVMH are the main luxury groups which strongly acted as consolidators in the last years (see Figure 20) and acquired many famous Italian brands.

Figure 20. LVMH and Kering Acquisitions, 1999-2014



Source: KPMG, 2014, Le acquisizioni di investitori esteri nel Fashion and Luxury.

128 Kering, 2015, Group Key figures, www.kering.com.

In 2015 Kering recorded a solid performance strengthened by dynamic sales with €11.6 billion of consolidated revenues[129]. Breaking down revenues by region shows that 31% of revenues were generated in Western Europe, 26% in Asia Pacific, 23% in North America, 10% in Japan and 10% in other countries.

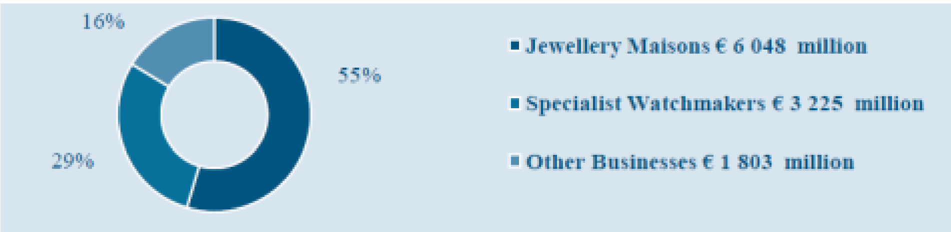
The luxury brands falling under the Kering Group which are in direct competition with LVMH are: Bottega Veneta, Alexander McQueen, Yves Saint Laurent, Gucci, Stella McCartney, Balenciaga, Boucheron and Sergio Rossi.

Compagnie Financiere Richemont

The Compagnie Financiere Richemont Group, based in Switzerland, is a key player in the luxury industry, with sales of more than 11 billion euros and 28,800 employees[130].

The Richemont Group was initially controlled by the Rembrandt Group Limited of South Africa, a company operating in tobacco, wines and spirits, gold and diamond mining industries as well as the luxury goods investments, and was born in 1988 by the spin-off of the international assets owned by Rembrandt Group. It owns several of the world's leading companies in the field of luxury goods, with particular focus in jewelry (55% of sales; see Figure 21), luxury watches (29% of sales) and writing instruments (Mont Blanc brand). Clothing and leather good sales amounted to 1,1 billion euros, with a share of 10% of total sales[131] (see Table 4).

Figure 21. Richemont, Sales by segments



Source: Richemont, March 2016 (Richemont fiscal year ends in March), Annual report and accounts.

Table 4. Richemont, Sales by product lines

12 months €m	FY16	FY15	Constant rates	Actual rates
Watches	5 098	5 168	-8%	-1%
Jewellery	3 881	3 325	8%	17%
Leather goods	698	610	9%	14%
Clothing	442	384	5%	15%
Writing instruments	382	361	1%	6%
Other	575	562	-4%	2%
Total sales	11 076	10 410	-1%	6%

Source: Compagnie Financiere Richemont, March 2016 (Richemont fiscal year ends in March), FY16 Annual results.

129 Kering, 2015, Group Key figures, www.kering.com.
130 Compagnie Financiere Richemont, March 2016 (Richemont fiscal year ends in March), Annual report and accounts.
131 Richemont, 2016, Annual Report and Accounts for 2016

Sales through the brands' directly operated boutiques and e-commerce accounted for 55% of the Group sales (the wholesale sales represented 45% of the total). Sales in the Asia-Pacific region accounted for 36% of the Group total, while sales in Europe and the Americas have respectively a share of 31% and 16%.
Richemont's strength has always been in the segment of hard luxury. In fact, the Group dominated the world' scene by owning several Houses such as: Cartier, Piaget, Van Cleef & Arpels, Vacheron Constantin, IWC, Piaget, Officine Panerai. The Group also had a relatively small stake in fashion and accessories with brand names such as Chloe, Sulka, Shanghai Tang and Dunhill.
Richemont emphasizes the stand alone nature of each brand belonging to its portfolio, acting as a behind the scenes player and granting full autonomy in brand management to its Houses.

<u>The Swatch Group</u>

The other big group dominating the luxury industry is the Swatch Group (approximately € 7.8 billions of sales). This Group was founded in 1983 by Nicolas G. Hayek through the combination of two large companies ASSUAG and SSIH. The merged group was called Société Suisse de Microelectronique & d'Horologerie until 1998, when the name was officially changed to Swatch Group. The group's headquarters are located in Berne, Switzerland, and it is engaged in the manufacture and sales of finished watches and jewelry, watch movements and components.
Currently, the Swatch Group owns 18 different brands, including Harry Winston, acquired in 2013. In recent years the Group has conducted its business in more than 160 countries and regions occupying almost a quarter of the total watch sales across the world.
Swatch Group has more than 36, 000 employees in over 50 countries. Net sales in 2015 amounted to 8.451 billion Swiss francs (approximately € 7.8 billion)[132]. Revenues streams were generated by two business segments: watches, jewelry and electronic segments, which accounted for 96.8% and 3.2% of total revenues respectively. Breaking down revenues by geographical areas shows that Asia accounted for 56.2% of total revenues, Europe for 33.4% followed by America 8.6% and Oceania and Africa accounting respectively for 1.1% and 0.7% of total revenues.

2.5 Current trends: vertical integration, consolidation, diversification, and war for talents

Majors players in the market are fighting for leadership, by increasing economies of scale and their international presence - especially in emerging markets located in Asia and the Middle East - and becoming more diversified, as well as more vertically integrated, than in the past.
The main trends observed in the industry over the last years are: consolidation, vertical integration, diversification, strengthening of corporate social responsibilities and war of talents.

[132] Swatch Group, 2015, Annual report.

1. **Consolidation**. The industry is moving more and more towards consolidation, through an increasing wave of mergers and acquisitions (M&A) driven by horizontal and vertical acquisitions. It seems that in the luxury industry size is becoming increasingly important[133] in order to have the critical mass to be international, to exploit scale economies, to smooth the business cycle, to provide growth, synergies and diversification, as well as to secure suppliers through better vertical integration.

   The positive outcome of a consolidation scenario is that large luxury conglomerates bring to the single brand: additional financial resources, the opportunity to share best practices and operating systems to the new acquired brand. The process of consolidation has therefore fueled the implementation of M&A activities (with the acquisition of many smaller brands by large groups) and vertical integration (to secure suppliers and bring the entire production process in house). They are both very demanding operations, which involve a careful and meticulous planning, as well as large financial and human resources.

   In the past years, large luxury conglomerates have exploited this opportunity, enriching their portfolio through the acquisitions of both well-known luxury brands and innovative niche players. They also acquired stakes in promising young designers in order to gain entry in additional, and potentially newer, segments of the market. On a smaller scale, these strategies has also been implemented by niche players.

   Some previous studies have reported an interesting trend concerning M&A activities performed by big conglomerates: it emerges that they tend to acquire companies having a long history but run by managers rather than the founding families[134].

   Among the largest operations of M&A there is the acquisition of Gucci by the French group PPR, today known as Kering, made in 2004 for a value of 6.1 billion €. In 2011, LVMH was awarded 100% of Bulgari for 4.3 billion €. More recently, in 2013, LVMH has scored a major acquisition, noting 80% of Loro Piana with a value of 2 billion euro. The Italian brand further enriched the already numerous list of Italian brands being acquired by foreign groups.

   The figure below shows all the M&A activities industry occurred in 2013 within the luxury industry. As seen in the previous paragraphs, the main actors of the M&A process were especially the big conglomerates.

[133] André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Program.
[134] KPMG, 2014, Le acquisizioni di investitori esteri nel Fashion and Luxury.

Figure 22. Luxury industry, M&A operations in 2013

Deal rank	Buyer	Buyer location	Buyer product sector	Acquired business/ Parent company	Acquired business location	Acquired business product sector	Deal value** (US$mil)	Completion date
1	***LVMH Moet Hennessy Louis Vuitton SA***	France	Manufacturer & retailer of luxury goods	***Loro Piana SpA*** (80% stake)	Italy	Cashmere & other high-quality textiles, apparel & accessories	$2,831	05/12/2013
2	***PVH Corp.***	United States	Manufacturer of apparel & accessories	The Warnaco Group Inc.	United States	Intimate apparel, sportswear & swimwear	$2,787	13/02/2013
3	***Swatch Group Ltd.***	Switzerland	Manufacturer of watches, jewelry & accessories.	***Harry Winston Inc.***/ Harry Winston Diamond Corporation (renamed Dominion Diamond Corporation)	United States	Jewelry & watches	$1,000	26/03/2013
4	TowerBrook Capital Partners L.P.	United States	Private equity firm	***True Religion Apparel, Inc.***	United States	Fashion jeans & sportswear	$750	30/07/2013
5	Apax Partners LLP	UK	Private equity firm	***Cole Haan LLC***/Nike Inc.	United States	Footwear & handbags	$570	04/02/2013
6	Apollo Global Management, LLC	United States	Private equity firm	***Aurum Holdings Limited***/ Landsbankinn hf.	UK	Retailer of jewelry & watches	$455	20/03/2013
7	***Kering S.A.***	France	Manufacturer & retailer of luxury goods	***Pomellato SpA*** (81% stake)/RA.MO SpA	Italy	Jewelry & watches	$390	25/04/2013
8	PAI Partners	France	Private equity firm	***Marcolin SpA***	Italy	Eyewear	$347	01/03/2013
9	Brentwood Associates, Inc.	United States	Private equity firm	Allen-Edmonds Shoe Corporation/Goldner Hawn Johnson & Morrison Inc.	United States	Footwear	$200	04/11/2013
10	Gemfields Resources plc	UK	Gemstone company	Fabergé Limited/ Pallinghurst Resources LLP	Switzerland	Jewels, accessories & other luxury goods	$133	30/01/2013
11	***Luxottica Group SpA***	Italy	Manufacturer & retailer of eyewear	Alain Mikli International SA/NEO Capital Private Equity LLP	France	Eyewear	$117	23/01/2013
12	Clessidra SGR SpA	Italy	Private equity firm	Gianmaria Buccellati srl (70% stake)/Buccellati family and Simest SpA	Italy	Jewelry & watches	$103	28/03/2013

Source: Deloitte, 2014, Global Power of luxury goods.

1. **Vertical integration**. A company is said to be vertically integrated when it controls several successive stages of the production process of its product: from design manufacturing to sales. Vertical integration can be of two types: upstream or downstream depending on the proximity to the final consumer. Through this practice large groups are able to strengthen the supply chain and have a greater control over the manufacturing process and the distribution process.
   - Upstream, the integration can be achieved through:
     - Restriction/leaving of licensing agreements;
     - Buying up of manufacturers.
   - Downstream, the vertical integration can be realized through:
     - Buying back franchised operations (in 1999-2000 Gucci bought back many of its Japanese and Spanish franchise stores[135]);
     - Opening of new directly operated stores (as many companies are doing in the last years).

[135] André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Program.

In the watchmaking segment of the industry, there is a widespread tendency for large watchmaker groups to verticalize their production processes, thus, reducing their dependence on external suppliers and sub-contractors by bringing them in house.

The Swatch Group was the one to initiate this verticalization process, soon followed by other leading groups such as Rolex, Richemont and LVMH. In this sector the acquisition of these specialist workshops has caused extreme difficulties for smaller brands, since it forces them to find new suppliers which, most of the times, are extremely expensive[136].

2. **Diversification**. This corporate strategy allows a company to enter into a new market segment or a new industry that the business is not currently in. By this strategy, the major luxury companies try to exploit economies of scale and scope while also reducing the overall risk of their activities.

   Many luxury companies have evolved their portfolio from mono-segment to multi-segment and from mono-brand to multi-brand. The key luxury conglomerates such as LVMH, Kering and Richemont are example of multi-brand/multi-segments companies. Swatch Group is a large luxury group multi-brand/mono segment as well as Estée Lauder.

   Diversification can be reached through two different ways:

   i) <u>Brand extensions and line extensions.</u>

   In luxury strategy the brand is ultimately linked to a specific legitimate universe: Rolex is a watch manufacturer, Fendi is a furrier, Ferrari is a carmaker. Usually it is assumed that when a brand operates outside of its universe, it loses its legitimacy. Nowadays it is not uncommon for brands to move out of their original sphere and extend their reputation to other sectors. Brands such as Chanel and Dior have moved from their haute couture sphere to ready-to-wear and accessories. This practice can be achieved through brand extension. In brand extension, the luxury brand implements its strategy out of the core business, into a new territory: an example is Hermés, the leather goods maker, which entered in silk wear. On the other hand, with line extension, the expansion of the product offerings affects the core business[137]. This means that brands create a second and a third line beyond its prestigious first line. An example is provided by Armani with its different product lines: Armani Jeans, Emporio Armani and Armani Exchange. Both line and brand extensions are ways to reach new consumers who were not on the radar for the brand.

   Despite the most recent recession, the luxury market was able to grow, due to the expansion of the product offerings. This has allowed luxury houses to grow more quickly, without being limited to their original trade.

   Both Armani and Bulgari were successful in implementing this strategy. Both houses, in fact, have been introduced in the hospitality industry. In 2005 Armani joined a partnership with EMAAR Properties. In 2006 Bulgari created the venture with US Company Mariott International.

[136] J. Hoffman, L. Lecamp, 2015, Independent Luxury: the four innovation strategies to endure in the consolidation jungle, Palgrave Macmillan

[137] Kapferer J.N., Bastien V., 2009, The Luxury Strategy: break the rules of marketing to build luxury brands, 2nd ed, Kogan Page

Furthermore, particularly when the brand is no longer in the hands of its founding family, the pressure from shareholders to leverage the value on other products is very strong, in order to improve return on equity.

ii) The multi-brand strategy.

This strategy allows to create an organization structure which combines the centralization of operational processes with the decentralization of creative processes. The advantages of implementing such a strategy are several, such as gathering greater relevance within the market in which the company operates, and serve effectively brand switchers (consumers who frequently change brands to experiment different products) through a greater product offering. Through the centralization of some business activities, companies often develop synergies across different divisions[138]. There exist three bases for synergies: leveraging core competencies; increasing market power and, last but not least, sharing activities and best practices. By adopting a multi-brand strategy, usually, companies can exploit manly two kind of synergies: efficiency synergies (despite not being as important as they are in other sectors) and growth synergies. The boundaries between these two are extremely blurry. For example, the transfer of know-how, on one hand, allows the brand to reduce costs through shared practices (efficiency synergy); on the other hand, it allows the acquired brand to exploit the opportunity to enter into a different segment of the market through the acquisition of knowledge that it didn't have before (growth synergy).

3. **Strengthening of social corporate responsibility**. Through this strategy, industry players aim at strengthening their reputation adopting many important initiatives in the social and cultural field. Many companies, such as LVMH, Kering, Tiffany & Co., finance medical researches and health programs, helping elderly, children and disabled. Furthermore, it is not uncommon for entities to form partnerships with universities to support students, future designers and industry managers.

   The Kering Group launched the Kering Corporate Foundation in 2009 to help end violence against women. The foundation works to provides assistance to survivors of domestic violence by collaborating with the Maple Women's Psychological Counselling Center in Beijing[139]. The Group has also developed partnership with several universities such as Parsons School of Design in the US and HEC Paris in order to attract, develop and retain the most imaginative talent[140].

   LVMH has proved its involvement in social responsibility by engaging in partnership with several entities. In 2013 it partnered with the Association Française des Managers de la Diversité (AfmD) to prevent discrimination and promote diversity; LVMH co-founded ARPEJEH an association helping people with disabilities in achieving their educational goals; furthermore, the group has an agreement with AGEFIPH, a French organization promoting the employment of disabled people into the private

[138] With the term synergy is meant the potential additional value arising from the combination of two or more firms, Damodaran A., 2002, Investment Valuation, 2nd ed.
[139] Kering, 2015, Activity Report.
[140] Kering, 2015, Activity Report.

sector. Last but not least, the group engaged in partnerships with a number of educational establishments and specialists schools to preserve expertise.[141]

4. **War for talents**. Since the creative talent is very crucial for the development of the luxury business, it is critical for industry players to be able to attract and retain the best talents[142]. Furthermore, the industry dynamism and high competitiveness require the search for good managers by companies and the capability to attract and retain them.

   Over the last years, there were many examples of this war of talent, especially for creative designer, with many movements of these managers from a luxury group to another (i.e. the move of Stella McCartney in 2001 from Head of design of Chloé – Richemont- to Creative Director of her own brand with Gucci Group).

   According to the Luxury Industry Specialists of KPMG, the large groups are more able than small-medium sized companies to attract and retain talents, because they can ensure a more dynamic management of human resources, through intra-group mobility, and more knowledge sharing among the different brands belonging to the group[143].

141 LVMH, 2015, Social Responsibility Report.

142 André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Program.

143 André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Program.

3. The luxury industry in the consolidation curve

3.1 The industry consolidation: a theoretical framework

Several studies on industry evolution indicate that many industries evolve through life-cycle stages. These stages are characterized by strong differences in the industry's growth rate and by dramatic changes in the number of players in the industry. Most new industries are initially highly fragmented and as soon as they mature they are object of a consolidation process.
Industry structure evolution has been for long a central topic of both economic and management research studies. In the literature, many theoretical models try to explain the pattern of industry consolidation. In this regard, three main streams of literature can be identified[144]:

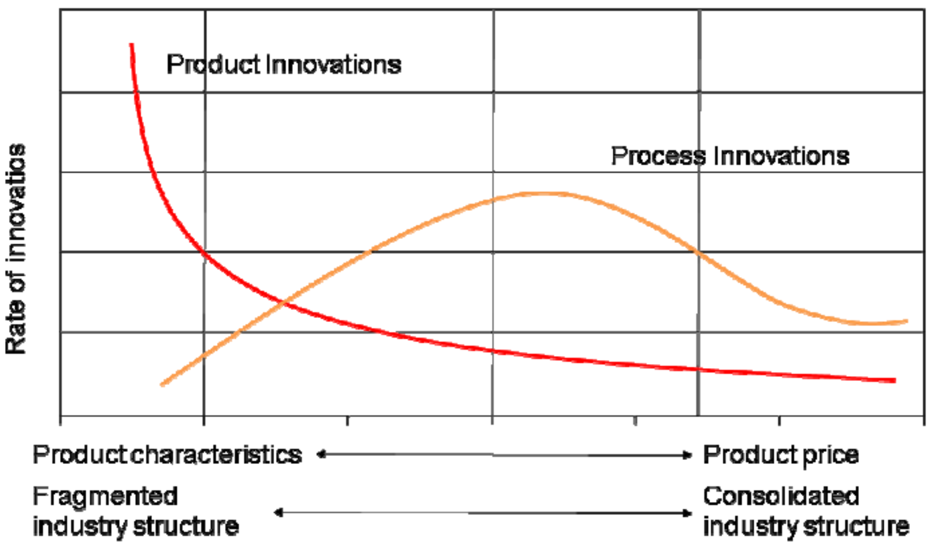
1. **the Merger Endgame model**. This theory of industrial development is based on extensive empirical research conducted by the Global management consulting firm - A.T. Kearney – which analyze large mergers and acquisitions made at global level from 1988 to 2001[145].
   This model considers the process of industry consolidation: an unavoidable step for all industries. The Merger Endgame model of industry consolidation can be described as a firms' race for market dominance, an endgame, toward an endpoint which is the final stage of consolidation process. This model is based on a few economic considerations. Firstly, all companies have to grow in order to stay independent and guarantee an appropriate return to their shareholders. Every firm which fails to grow or experiences a very slow growth (especially if it is a small sized company) is very vulnerable and risks becoming a victim of the consolidation process (the target of acquisitions). In addition, such a company, if it waits too long before merging with other companies, runs the risk of being acquired at "sales" prices. Second, especially when the industry market (or demand) becomes mature, the company cannot rely only on internal growth but it should combine the organic growth with the external one through M&A operations. Third, the competences that companies acquire and develop with the participation to the mergers and acquisitions process (i.e. competences linked to the "due diligence" and organizational integration) further sustain and fuel additional waves of industry consolidation. As stated by Nilsson et al. "*the economically based endgame model of the consolidation process could thus be described as an inevitable and predictable but also a manageable process gradually concentrating industries*"[146]. Companies have to actively participate to the race for dominance and growth, adopting strategic choices in order not to suffer competitive

144 Nilsson C-H., Lindskog CV., Brink J., Industry Consolidation – A Case from the Consolidation Process within the European Industry.
145 Deans K., Kroeger F., Zeisel S., 2002, The consolidation curve, Harvard Business Review, (December issue).
146 Nilsson C-H., Lindskog CV., Brink J., Industry Consolidation – A Case from the Consolidation Process within the European Industry.

disadvantage with respect to other industry players. This theory will be further investigated in the next paragraph.

2. **Industrial life cycles theory**. This theory tries to explain the pattern of industry consolidation from the viewpoint of technological change. According to this theoretical framework, industry consolidation is mainly due to technological progresses which completely change the competitive nature of firms' business. In this case, the explanation of market structure's evolution relies on the technological life cycle. During this cycle, industry evolve from an initial stage, where firms competition is essentially based on product innovation, towards another stage, in which successful product design and best practices dominate and competition is based more on process innovations and cost-cutting strategies[147]. The gradual shift of competition from product innovations to process innovations forces firms to achieve economies of scale, pushing them towards a stage of consolidation. It is the nature of technology and innovations which predominantly shapes the industrial structure, forcing industry to consolidate.

Figure 23. The industrial life cycle



Source: Nilsson C-H., Lindskog CV., Brink J., Industry Consolidation – A Case from the Consolidation Process within the European Industry (modified from Utterback and Abernathy, 1975[148]).

This theory entails that the pattern of industrial consolidation is not the same for all industries and it is not an unavoidable process, but, it depends on the technological innovation, which modifies the nature of competition, strengthening the competitiveness of newcomers and changing the consumers behavior[149]. Empirical studies of this stream of literature show several patterns of industry evolution.

[147] Utterback, J. and Abernathy W., 1975, A Dynamic Model of Process and Product Innovation, OMEGA, Vol.3, No. 6.
148 Utterback, J. and Abernathy W., 1975, A Dynamic Model of Process and Product Innovation, OMEGA, Vol.3, No. 6.

[149] Christensen C., 1997, The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail, Harvard Business Press.

According to Breschi et al. (2000)[150], some industries do not experience a consolidation process, remaining rather fragmented. In addition, independently from the degree of industrial consolidation, every industry always runs the risk of becoming more fragmented rather than evolving along the consolidation pattern. For this theory a strong innovation can always be a source of fragmentation or disintegration for any consolidated industry[151].

3. **The sociological-based theory**. This theory attempts to explain the pattern of industry consolidation from a sociological perspective. Accordingly, the industry consolidation is "*explained as a process of imitation and copying behavior inspired by the activities and actions of other industrial firms"*[152].
   The imitation process can be prompted by many factors such as examples of successful M&A, persuasive business press and dominance of consolidation operations. In this theory, the consolidation race is not determined by economic or technological factors, but is the outcome of social pressure to adapt firms' strategy to the dominating view. According to Powell and Di Maggio (1983)[153], the main argument for these sociological theories of industry evolution relies on "*the processes of mimicking and institutionalizing behaviors, legitimizing certain behaviors within society and discrediting others*"[154].
   In addition, actively participating to the consolidation race can be also driven by personal gains of the top management (such as aspirations to increase their power and personal fame) or by particular interests of certain shareholders rather than by the search of competitive advantage[155].

Regardless of the strong differences among the three main theories explaining the industry consolidation process, it is possible to identify some similarities. First, in all theories the consolidation process affects all the industry firms and not just the single for different reasons (the search for market dominance in the economic-based theory; the search for economies of scale in the technological-based theory; the social pressure in the sociological based theory). Second, the consolidation process tends to foster and fuel other consolidation operations. This self-reinforcing mechanism is caused in the Merger Endgame theory by the necessity to speed up the participation in the consolidation game, as suitable targets are quickly acquired. In the industrial life cycle theory, it is determined by potential gains coming from scale-enhancing innovations. In the sociological theory, this reinforcing mechanism relies on the collective or individualistic pressures which force firms to participate in the race.

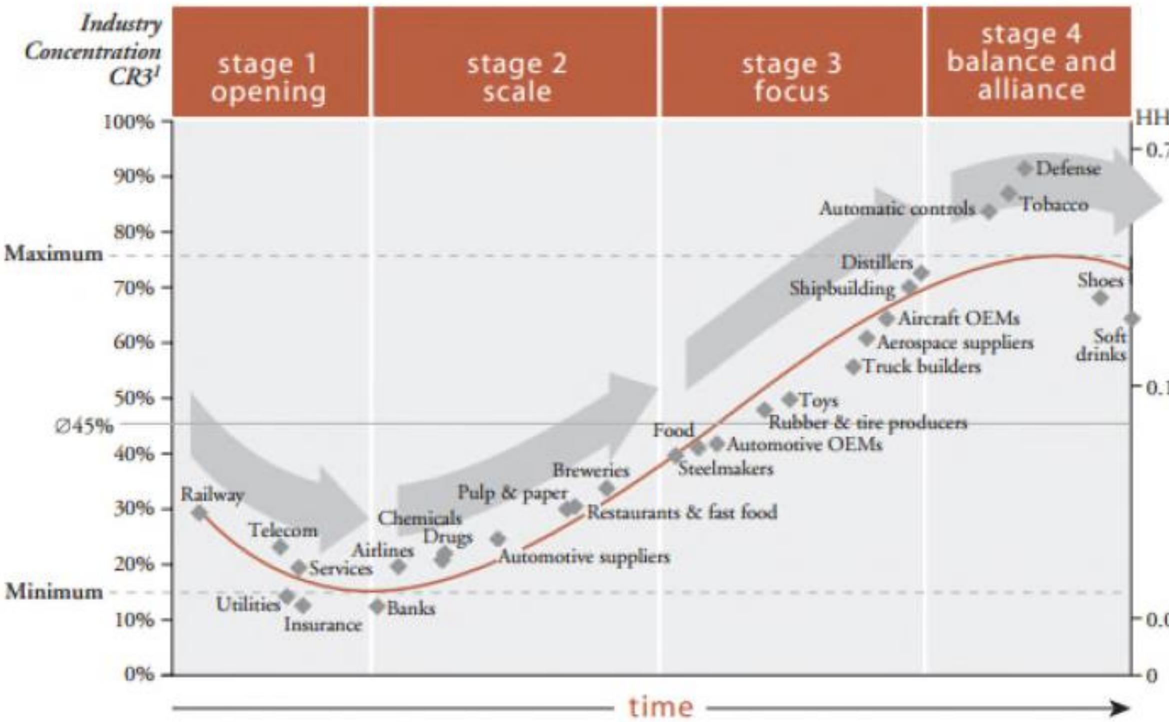
150 Breschi S., Malerba F., Orsenigo L., (2000). Technological Regimes and Schumpeterian Patterns of Innovation, The Economic Journal, Volume 110, Issue 463.
151 Nilsson C-H., Lindskog CV., Brink J., Industry Consolidation – A Case from the Consolidation Process within the European Industry.
152 Nilsson C-H., Lindskog CV., Brink J., Industry Consolidation – A Case from the Consolidation Process within the European Industry.
153 Powell, W. P. DiMaggio, (1983) The Ironcage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields, American Sociology Review, Vol. 48, No. 2.
154 Nilsson C-H., Lindskog CV., Brink J., Industry Consolidation – A Case from the Consolidation Process within the European Industry.
155 Nilsson C-H., Lindskog CV., Brink J., Industry Consolidation – A Case from the Consolidation Process within the European Industry.

In the following paragraphs I will focus on the economic-based theory, the Merger Endgame, which is able, more than the other two theories, to give some useful guidelines about the different stages of the industry consolidation process and even on the optimal strategies to be adopted by niche firms in each stage to win the consolidation race.

3.2 The consolidation curve: the Merger Endgame

As already seen in the previous paragraph, the Merger Endgame model was developed by the Global management consulting firm, A.T. Kearney, which analyzed mergers and acquisitions involving 25,000 companies at global level from 1988 to 2001 (representing 98% of the worldwide market)[156]. This empirical research showed that most industries follow a predictable consolidation life cycle that it is similar to an S-curve, named the Endgame Curve (see Figure 24). However, some specific industries do not consolidate at all (such as the restaurant industry).

Figure 24. The Merger Endgames S curve



Source: AT Kearney Analysis (G.K. Deans, Kroeger F., Zeisel, S.), first publication 2002, The consolidation curve, Harvard Business Review, December issue.
Note:
(1) Market share of the three largest companies of the total market based on Value-Building growth Databse (25,000 companies).
(2)HHI= Hirschman-Herfindahl Index corresponds to the sum of the squared market shares of all companies and is greater than 90%, the axis logarithmically plotted.

In particular, after years of studying mergers, A.T. Kearney affirms that once an industry forms or is deregulated, it moves through four different stages in a consolidation lifecycle:

[156] Deans K., Kroeger F., Zeisel S., 2002, The consolidation curve, Harvard Business Review, (December issue).

1. **Stage 1 - Opening.** The first stage, Opening, typically begins with start-ups and it is usually characterized by an unceasing pace of innovation, countless opportunities and risks. In this stage, entry barriers are generally low and many companies enter the market, attracted by profitable business opportunity. In this phase, industries - which start with only a few players - generally become more fragmented: the three largest players usually hold a global market share between 10% and 30%. According to this study, this space in the S-curve is occupied by deregulated or privatized industries such as energy, telecommunications, railroads and insurance. Other industries which fall in this stage are start-ups in new fields such biotechnology and on line retailing.

   In this point of the S-curve, the focus of industries is to defend their competitive advantage by building scale, acquiring an international footprint and establishing entry barriers in order to protect their intellectual ideas and innovations. In addition, industries start gaining acquisition knowledge and competences in order to be prepared to face the next two stages of consolidation.

2. **Stage 2: Scale**. This stage is entirely focused on building scale, pushing the main players to expand both through organic growth and mergers & acquisitions. Although the ranking of market leaders frequently changes, major players start to emerge. In the scale phase, the three largest companies usually hold a global market share which ranges from 15% to 45%. The consolidation game enters in its core phase, with ferocious and aggressive attacks to major competitors in order to capture market shares, to expand their global footprint and to reach the next stage of consolidation life cycle. According to A.T. Kearney analysis, industries that fall in this stage include airlines, automotive suppliers, banks, hotel chain and pharmaceuticals.

   Companies must have gained merger-integration skills in order to absorb new companies, without losing their core culture and to be able to retain the best employees of the acquired firms. Critical in this stage is the firm capability to build a scalable IT platform in order to guarantee a very sharp integration of the new companies.

3. **Stage 3: Focus.** Differently from the scale stage, the focus stage is not characterized by countless merger activities but is dominated by some megadeals and large-scale consolidation. In this phase, the top three players cover a market share between 35% and 70%. Industries that fall in this stage include shipbuilding, still producers, aerospace suppliers. The main goal now is to become one of the few global industry giant. According to A. T. Kerney’s study, by this time there are still generally from 5 to 12 major competitors. In this stage, the game’s rules are well known and only an outside event or a disruptive innovation can be able to cause significant changes. At this point, it is possible to identify the main players that will likely survive the final stage.

In stage 3, industry firms have to strengthen their core capabilities, focus on profitability and be able to quickly recognize start-up competitors in order to decide if to acquire, imitate or destroy them.

4. **Stage 4 - Balance and Alliance**. The top of the Endgame Curve is the final stage, the end of the Endgame journey. The Balance and Alliance stage is a calmer phase with respect to the previous ones, and further consolidation is highly unlikely, also because of anti-trust reasons.
   The industry giants reign: this is the case of the tobacco and defense industries as well as shoes industry. At this stage, the top three player control from 70% to 90% of the global market. Because growth is more challenging in this phase (large companies have in fact already maximized their market penetration), large companies may establish alliances with other peers. In this stage, market is dominated by just a handful market leaders which maximize their cash flow, defend their market position and adapt to changes in the market structure or to technological innovation. Here firms have to find new ways to grow in mature industries and to be alert to the risk of potential industry regulation.

According to the Endgame model, the long-term success of a company is strictly linked to the way it progresses through the stages of industry consolidation. For this reason, it is vital for firms to understand at what point their industry is in the cycle. To win the consolidation race, speed is crucial, as well as managers' merger competences, in particular during the middle stages of consolidation. Slower companies risk to become acquisition targets or to disappear. As stated by Deans and al. "*most companies simply won't survive to the endgame by trying to stay out of the contest, or worse, by ignoring it*"[157].

3.3 The consolidation curve and niche strategies

As seen in the previous paragraph, as industry consolidates through the four stages of the Endgame curve – Opening, Scale, Focus, Balance and Alliance – only a few powerful companies dominate the market. Along the S-curve, niche players are progressively more at risk of becoming victim of acquisition targets or being forced out by the dominant players.

Further research developed by A. T. Kearney (Kroeger, Viziak and Moriarty, 2008) focused on more than 600,000 small and medium sized companies at global level - which had achieved the highest revenue growth and highest market capitalization growth over a sustained period of time - in order to identify successful strategies adopted by these niche companies for remaining viable and profitable over time[158]. As mature industries move toward consolidation, niche firms' strategies should try to be as much as possible forward-looking in order to anticipate new trends.

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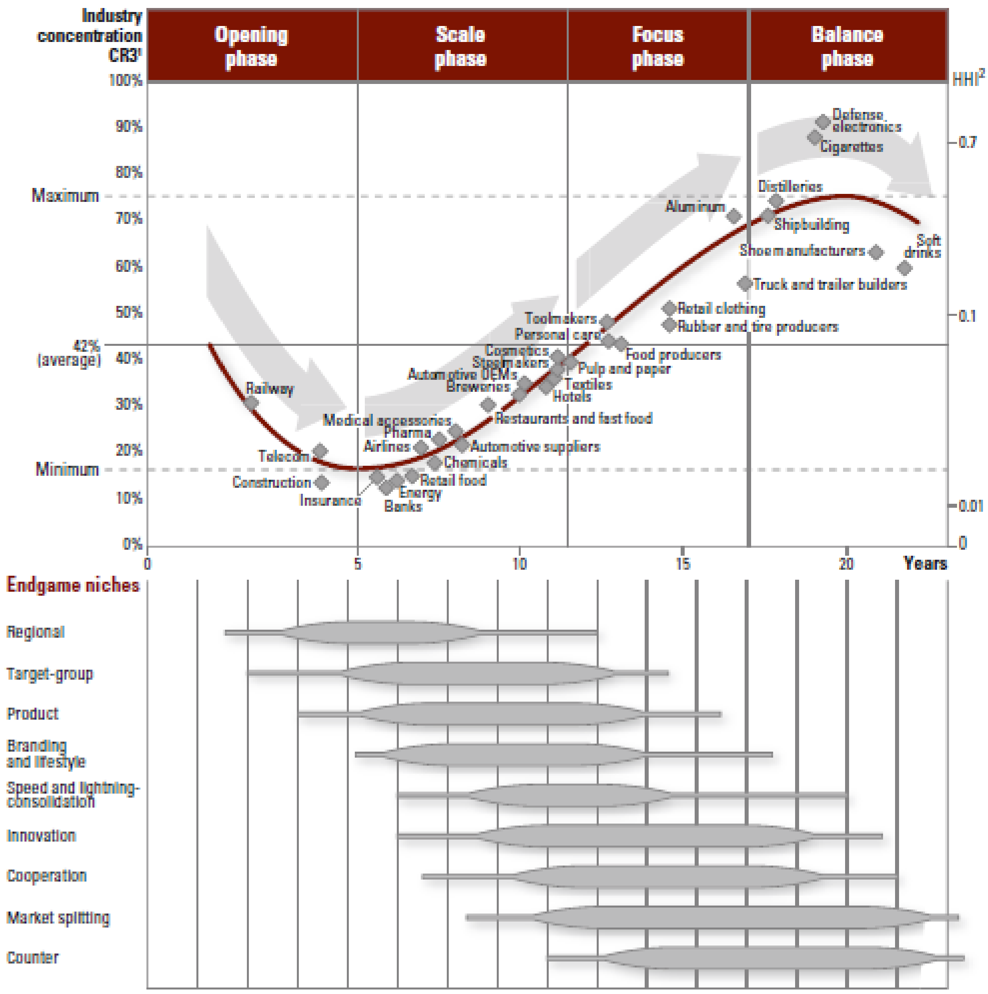
[157] G.K. Deans, Kroeger F., Zeisel, S. (A.T. Kearney), first publication 2002, The consolidation curve, Harvard Business Review, December issue.

158 Kroeger F., Vizjak A., Moriarty M., (AT Kearney), 2008, Beating the global consolidation endgame: nine strategies for winning in niches, McGraw-Hill.

“*Beating the Global Consolidation Endgame: nine strategies for winning in niches*” (2008)[159] - the book published in 2008 and based on A. T. Kearney empirical research over the past 15 years - identifies nine key strategies that niche companies should adopt in order to outperform their markets and gain the largest benefits from consolidation. Each niche strategy is most effective only in some specific traits of the consolidation curve (see the updated consolidation curve in Figure 25).

Figure 25. Consolidation curve and niche strategies



Source: A. T. Keartney (Analysis and database), Kroeger F., Vizjak A., Moriarty M., A. T. Kearney, “A dangerous time to be a niche player“, Management Agenda.
1. CR3= market share of the three largest companies of the total market based on the Value Building Growth database (660.000 companies), A.T: Kearny analysis.
2.HHI= Hirshman –Herfindahl Index, which corresponds to the sum of the squared market shares of all companies and is greater than 90%; the axis is logarithmically plotted

159 Kroeger F., Vizjak A., Moriarty M., (AT Kearney), 2008, Beating the global consolidation endgame: nine strategies for winning in niches, McGraw-Hill.

The nine niche strategies are the following:

1. **Regional**. These firms have an optimal knowledge of the customer needs in a certain geographical area. In the brewing industry, an example of a regional niche leader is the German beer maker.
2. **Target group**. Companies in this niche are focused on specific customer segments, ensuring them extensive personalized services. Luxury hotel chains, such as Four Seasons, exemplify this strategy.
3. **Product**. These companies outclass competitors in providing a specific product. A successful example in this niche was Cable network CNN before becoming part of Time Warner.
4. **Branding and lifestyle**. Companies in this niche have the ability to combine the power of target group and product niches to "*create communities of dedicated customers who value the brand name"*[160]. In this niche, some successful examples are given by luxury labels such as Porsche and Montblanc.
5. **Speed and lightning consolidation**. The characteristic of these firms is being fast-growing and being able to displace the current market leaders. Examples in this niche are Facebook and Amazon.
6. **Innovation**. These niche players have a strong market position thanks to innovative products (i.e. Apple and Logitech).
7. **Cooperation**. Smaller firms can establish alliances to face the competition of the largest players. Good examples of cooperation strategies are Ace Hardware and the Star Alliance in the airline sector.
8. **Market splitting**. Companies in this niche exploit weaknesses in the value chain to acquire competitive advantage. A successful company in applying this strategy is IBM when it split the market by segmenting its IT offerings into separate and distinct markets, becoming a leader in this niche.
9. **Counter**. These niche players exploit the weaknesses or strengths of industry leaders, forcing them either to modify their strategies allowing niche firms "*to swim in the slipstream*"[161]. According to A.T. Kearny study, examples of counter-niche companies are Japanese automakers and NetJets.

The following striking findings emerge from A. T. Kearney empirical research:

[160] Kroeger F., Vizjak A., Moriarty M., A. T. Kearney, A dangerous time to be a niche player, Management Agenda.
161 Kroeger F., Vizjak A., Moriarty M., A. T. Kearney, A dangerous time to be a niche player, Management Agenda.

1. All industries (every single one of the 250 tracked) face a global consolidation process over roughly a 25-year horizon. A. T. Kearney's theory predicts a merger endgame in which the largest three or four global companies will cover 60-70% of global market revenues.
2. Only few niche companies are able to survive during the consolidation cycle. The merger endgame theory estimate that 90 percent of the existing firms nowadays, will not be around in 25 years**.**
3. For every niche player**, "***there is a time to fight the game and a time to sell"***.** Each of the global consolidator has copious acquisition opportunities among which to choose the best targets to be acquired to become a solid and diversified global player.
4. Although global consolidation usually brings the 70% of the market revenues in the hands of 3-4 global players, the remaining 30% of the business survives thanks to one of the niche strategies mentioned above. For smaller companies is crucial to analyze and understand the competitive context and to identify the existent market potential which has not been yet exploited.

3.4 Which is the luxury industry's stage in the consolidation curve?

As seen in the previous paragraphs, the vast majority of industries consolidate, following a similar pattern. Some industries move slower, and others faster.

The luxury sector is not among the industries plotted in the Endgame curve by A. T. Kearney's analysis, reported again in Figure 26. It is possible to identify there some sectors which are close to the luxury sector and - to a certain extent - may be used as a proxy for some luxury categories. In particular, the shoe manufacture and distilleries industries are positioned in the final stage of the endgame curve, the Balance phase, while retail clothing falls in the focus stage. The personal care sector is at the beginning of the focus stage. The cosmetic industry occupies the space between the Scale and Focus stage. According to these proxies, the luxury sector should be positioned between the end of Scale stage and the last two stages of the consolidation curve.

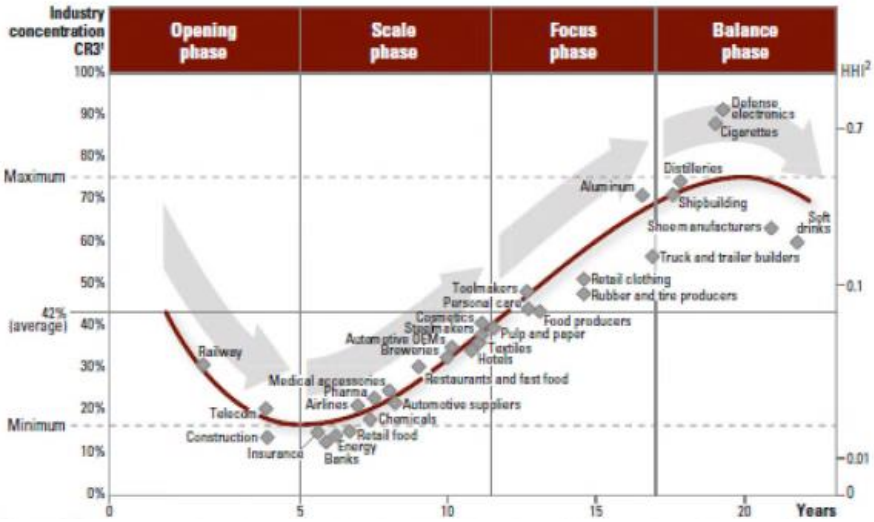
As a matter of fact, the luxury market is highly concentrated: according to the 2016 Deloitte Luxury Report, the economic concentration of the top 10 luxury goods companies is equal to more than 50% of the market. More precisely, the revenues of the top 10 luxury companies account for approximately 51% of the Top 100 luxury companies' revenues ($252 billion). However, if only the three largest players are taken into account, as made in the Endgame curve, the concentration of the global market share falls to 26%. If the Swatch Group is included too, the market share rises to 30%. The largest conglomerate – LVMH – has more than $40 billions of total revenues and covers a market share of 16%. It is more than three times larger than the second player.

As stated by Hoffmann and Lecamp in "Independent players"[162] "*In an increasingly challenging and globalized luxury environment, companies are fighting to escape from the ever growing clout of luxury*

[162] Hoffmann J., Lecamp L., 2015, Independent luxury. the four innovation strategies to endure in the consolidation jungle, Palgrave Macmillan.

"Conglomerates" – Swatch Group, LVMH, Kering and Richmont. As of 2015, these "big four" own more than 100 brands and are maintaining a constant pace of acquisition, relying on vertical integration to secure supplies (and deprive competitors of them), which has particularly damaging consequences for independents. Most independent are struggling to survive and end up being acquired or going out of business".

Figure 26. Consolidation curve



Source: A. T. Keartney (Analysis and database), Kroeger F., Vizjak A., Moriarty M., A. T. Kearney, 2008,"A dangerous time to be a niche player", Management Agenda.
1. CR3= market share of the three largest companies of the total market based on the Value Building Growth database (660.000 companies), A.T: Kearny analysis.
2.HHI= Hirshman –Herfindahl Index, which corresponds to the sum of the squared market shares of all companies and is greater than 90%; the axis is logarithmically plotted

Among the different product categories (shoes & leathers goods, ready-to-wear & fashion, accessories, jewels & watches, fragrances and cosmetics), Jewelry & watches together with shoes & leather are the luxury segments characterized by a higher degree of consolidation. However, in each segment the dominant players differ: in Jewelry & watches the market is dominated by Swatch, Richemont and Rolex, cosmetics and fragrance by Estée Lauder and L'Oreal Luxe, the shoes and leather goods by LVMH and Kering.

As seen in the previous chapter, over the past years, the process of consolidation has fueled M&A activity in the luxury goods industry, with the acquisition of many smaller luxury brands by large luxury conglomerates. Becoming a successful luxury goods firm - especially on a global scale -requires significant resources, knowledge and experience. Consolidation – essentially through the acquisition of many smaller luxury brands by large conglomerates – is not only the way for smaller companies to survive in the consolidation jungle but also the way of being able to grow and become a global luxury brand.

However, even in the strong last two stages of the consolidation curve – as suggested by A. T. Kearney analysis – niche players can be successful if they are able to fully understand the competitive landscape and to adopt the right strategies in the right moment.

4. Analysis (ex post) of the strategies of the group affiliated brands versus those of independent players

4.1 Methodology of the analysis

In the previous chapters, I focused on one hand on the strategic groups' literature and on the other hand on the analysis of the luxury industry, on its main features and trends and on the luxury industry's stage in the consolidation curve.

As seen in the literature review of strategic groups a full understanding of industry's characteristics is crucial in developing a solid strategic group analysis. In particular, my analysis will focus on strategic choices of luxury companies belonging to two clusters of firms: group affiliated brands versus those of independent players. In fact, as seen in the previous chapters, the luxury industry has experienced a strong consolidation process over the past years. On one hand, the market is dominated by large conglomerates such as LVMH, Kering, Richemont and Swatch Group; on the other hand, an important number of independent players still continues to exist and to be competitive in the luxury landscape. My analysis will try to identify the main strategies pursued by these two clusters of firms.

As underlined by Leask in its work "Is there still value in strategic group research?" in 2004[163], the strategic group theory continues to offer a valuable way to grouping firms according to their strategy if the following conditions are met:

- the set of variables to use in any strategic groups analysis should be industry-specific and should accurately reflect firms' strategic choices;
- in addition, the inclusion or exclusion of a specific variable should be supported by theoretical reasons;
- wherever it is possible, it is useful for the selection of strategic variable to make reference as starting point to previous studies in order to enrich industry-specific data base on strategic choices.

In the literature review, there are no strategic groups researches focused on the luxury sector and this makes my work harder. Very few studies attempt to identify and map strategic groups in the fashion industry, although concerning a very limited geographical area (Bonetti and Schiavone classified strategic groups in the fashion industry in Campania, 2014[164]). Other studies focused on the strategic and competitive groups in the larger clothing and textile industry (McNamee and McHugh 1989[165]) or in the clothing retail (Guercini and Runfola, 2004[166]). Another difficulty is represented by the fact that the luxury industry embraces different sectors such as clothing, shoes manufacture, cosmetics and other ones.

In developing this work, I adopt the conceptual framework of Porter's value chain, as made by other researches, focused on the luxury and fashion industries (Bonetti and Schiavone, 2014; André et alt.,

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[163] Leask G., 2004, "Is there still value in strategic group research?", Aston Business School Research.

[164] Bonetti E., Schiavone F., 2014, Identifying and mapping strategic in the fashion industry, International Studies of Management & Organization, December 2014.

165 McNamee P., McHugh M., 1989a, Mapping competitive groups in the clothing industries, Long Range Planning, 22(5).

[166] Guercini S., Runfola A., 2004, Sourcing strategies in clothing retail firms: product complexity versus overseas supply chian, Journal of Customer Behavior, 3 (3).

2002[167]) in order to identify the strategic dimensions which characterize the luxury companies' conduct. However, differently from the aforementioned studies, I will take into account not only the primary activities of Porter's value chain, but also support activities. The argument behind this reasoning is that it is not possible to compare the strategies of the group affiliated brands without analyzing the entire value chain, including support functions that are usually consolidated by large groups. In fact, neglecting support activities in this strategic analysis would mean not considering one of the critical element on which is built the competitive advantage of conglomerates.

4.2 Analysis of Porter's value chain and of the most strategic dimensions for luxury companies

The concept of value chain was first introduced by Porter in his 1985 famous work "Competitive Advantage: Creating and Sustaining Superior Performance"[168]. The value chain is a framework that helps to analyze the different activities through which companies can create value and competitive advantage. Porter classified the main activities needed to deliver a valuable product or service to the customers into two kinds of activities:

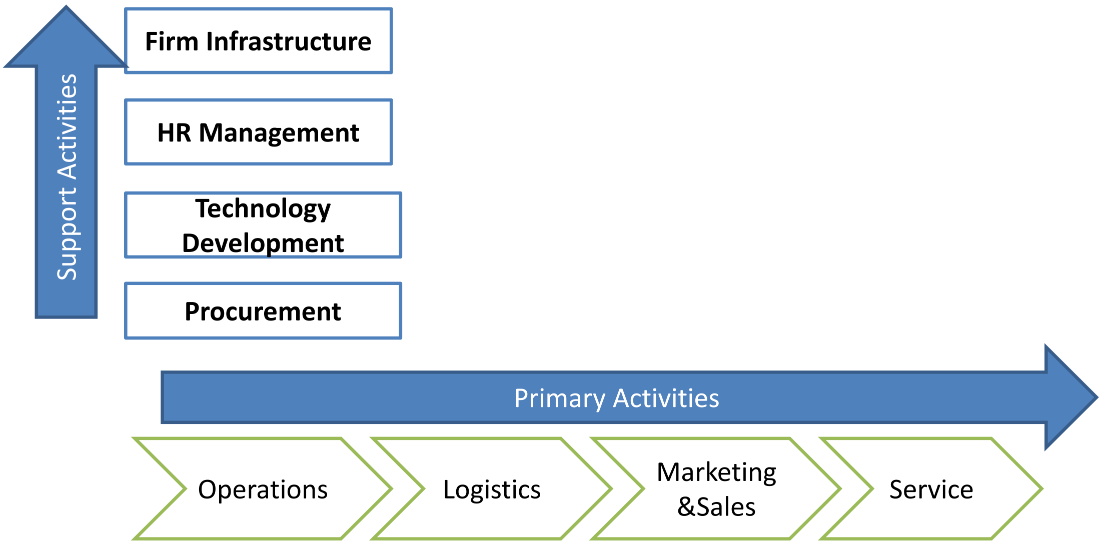
i) **primary activities**. The primary activities related to all the activities needed for the creation of a product or service and for its sale on the market. Porter includes in this category: *inbound logistic* (receiving, storing and inventory control), *operations* (all activities needed to transform the inputs into the final product, such as manufacturing, packaging, etc…), *outbond logistics* (the activities required in order to deliver the final product to the customers: order fulfillment, warehousing, transportation, etc..), *marketing and sales* (distribution channels, advertising, retail management, etc…), and *service* (all services which strengthen the product's value and the relationship with customers: customer support, premium service, after sale loyalty program, etc..).

ii) **support activities**. Support activities are those activities which assist the primary ones and usually include the *firm infrastructure* (includes general management, finance and planning, legal, accounting, etc..), the *management of human resources* (recruiting, compensations of managers and employee, career paths), *technology development* and *procurement (*of raw materials).

Regarding primary activities, it is possible to identify five strategic parts in the value chain which are crucial in creating a competitive advantage for luxury companies: sourcing, design, manufacturing, marketing and distribution.

167 André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Prog.
168 Porter M., 1985, Competitive Advantage: Creating and Sustaining Superior Performance, New York, Free Press.

Figure 27. Porter's value chain in the luxury sector



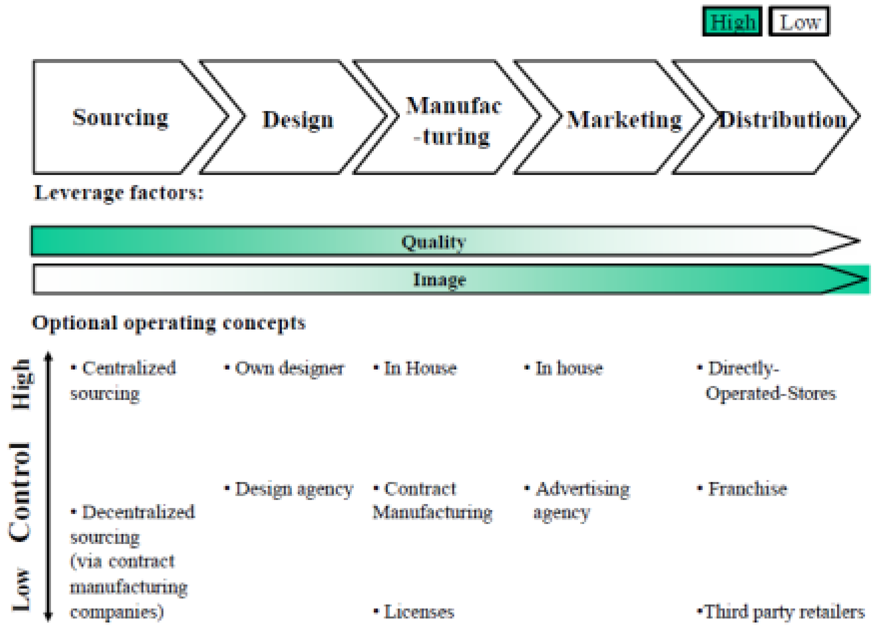
Source: personal representation.

As showed in figure 28, the different ways according to which the different parts of the value chain can be managed imply a differ degree of control of these activities by the company. As in Bonetti and Schiavone, the different level of control can be considered as a consistent proxy of the strategic weight assigned by a company to each stage of the value chain. The different ways of management of the value chain's stages vary from a maximum degree of control when the activities are internal and directly managed, to a minimum degree of control when the activities are outsourced. In between these two choices of control, there is an intermediate level where activities are managed through a controlled outsourcing or through partnerships. The intermediate solution tries to combine the benefits associated to each of the other two alternatives.

In addition, the different ways of managing the activities can also differ in the intensity with which they are conducted, thus originating even hybrid solutions.

On average, to a higher degree of control on value chain corresponds a higher investment by the company and a higher incidence of fixed costs. As seen in the previous chapters, over the last years, most of the luxury companies tended to strengthen their control over all aspects of business activities (sourcing of raw materials, manufacturing, product design, marketing and distribution) in order to protect their brand heritage, ensuring a high quality product and service. As a consequence, vertical integration has been an important driver of the M&A activities in the recent years. The strategic choice regarding the ownership of different stages of the value chain – on one side - allows the luxury company a strict control on brand's quality, but – on the other side - it requires higher capital requirements and greater business risk.

Figure 28. Analysis of the value chain



Source: André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Prog.

1) Sourcing: access to top suppliers and their technical (or artisan) expertise is critical for luxury companies both for their competitive positioning and for their brand's reputation. The direct or indirect control of the major suppliers is essential to secure key raw materials which are becoming increasingly scarce and are crucial to guarantee a superior manufacturing quality, especially for artisan brands. This stage in the value chain is particularly critical for luxury companies specialized in leather goods and spirits.

In large companies, procurement functions typically can be managed in three different ways:

i. *de-centralized*: each business unit executing their procurement activity locally, being responsible for supplier selection, executing orders, and managing supplier relationships;
ii. *centralized*: most of the procurement functions is run at central level, including supplier relationships;
iii. *hybrid*: this third model is the most common and is a hybrid of centralized and decentralized functions. In this case, only the strategic activities such as supplier selection, performance management, deployment of key initiatives, are managed centrally, while the operational elements of the procurement activity are decentralized.

The key benefit stemming from a centralized procurement – and in particular from centralized deals and contracts with mayor suppliers and relationship management - is the stronger bargaining power of the company towards suppliers.

2) Design. As known, for luxury goods, product design and aesthetic are crucial in creating a unique product able to inspire emotions to the customers. Regarding this strategic dimension, it is possible to identify two different styles of management:

i. tight control in companies where this dimension is considered more strategically relevant with respect to the others, thus design cannot be delegated to third parties. In this case firms have their own designer, because they build their competitive advantage on it.
ii. less control when this stage of the value chain is delegated to a design agency.

3) Manufacturing. The strategic relevance of this dimension can be easily evaluated mainly through the firms' choice about "make or buy". However, these two alternatives do not fully cover the range of possibilities to manage this activity. There is in fact an intermediate solution that – albeit similar to the "buy" choice – combines the benefits of the two approaches (buy and make). In this case, firms rely on outside providers but they tend to build long lasting relationship with them, by transferring know-how, ensuring stability of orders or providing technical assistance. This third solution – characterized by strong and lasting ties and a high degree of involvement of outside providers – was named "quasi-vertical integration" by Grant et al. (1991), "value-adding partnership" by Lawrence (1988) and "in-partnership buy" as opposed to "pure buy" by Bonetti and Schiavone (2014).

Summing up, there are three different manufacturing strategies:
i. the "*make*" strategy which concentrates in house the main production activities, obtaining the best level of compliance of the product to the company's manufacturing standard and schedules. In addition, this way of management allows companies to easily change the quantity of the production and also its characteristics. By contrast, this strategy implies higher production costs with respect to the "pure buy" and "in-partnership buy" strategy;
ii. the "*in-partnership buy*" strategy which relies on long lasting relationships with suppliers can exploit benefits similar to those of the "make" strategy without sustaining the same production costs. This strategy makes the supply more flexible, allowing to cope with an unpredictable demand;
iii. the "*pure buy*" strategy – which consist in giving in outsourcing the production activities – has the only advantage to offer a lower purchase price. This benefit is counterbalanced by the need to spend resources for the quality control and for the research of suppliers. In any case, to this strategy is associated the higher risk of having productions not fully compliant with the desired quality level and the inability to make plans to medium term.

4) Marketing. The luxury industry is more a "pull" than a "push" industry. For this reason, luxury firms have to commit substantial resources in advertising both at corporate and product level. On average, luxury goods industry invests more than 7% of its sales in advertising. The largest luxury companies spend a greater share of their turnover in advertising (on average 12%). The marketing activities can also be managed in two different ways: in house or delegating an advertising agency.

The rise of digital marketing is changing the way luxury brands engage with customers. In particular, brands that can integrate technology into brand and product experience are well placed in order to reach new boundaries, strengthen brand awareness, and broaden their market footprint. Consumer experience will be increasingly interconnected with the innovative use of digital platforms to reach the growing number of internet and smart phone users in luxury markets. Many luxury companies are investing in digital marketing in order to enrich the relationship with the customer before, during and after the purchase through valuable and sophisticated digital content. Some luxury companies, such as Gucci, have been very highly ranked in digital customer experience.

5) Distribution. This stage of the value chain is considered the key strategic element for the luxury companies' strategy. As stated by a luxury-goods industry analyst company at J.P. Morgan [169]" *If there is one critical word in the luxury business, it is "execution". People think about the luxury business in the wrong way - they think about brands. But luxury companies are primarily retailers. In retailing, the most important thing is execution, and execution is all about management. You may have the best designed product, but if you don't get it into the right kind of shop at the right time, you will fail."*

This probably explains the increasing trend of owning and controlling the distribution in the luxury industry. As known, there are three main distribution models:

i. "*own direct distribution*", when the companies sell its product in its directly operated stores (DOS), ensuring the highest degree of control over distribution channels and a direct and continuous relationship with its customers. However, "own direct distribution" requires high investments in terms of capital, human resources and skills.
ii. "*in-partnership distribution*", when firms use franchising or other kinds of membership in order to develop a broad network of stores under its own brand. This strategy allows the company to have a medium level of control on channel distribution (and a good bargaining power towards its distributors) without investing substantial resources as in the first solution, the "own direct distribution";
iii. "indirect distribution". In this case companies use a broad network of commercial intermediaries to sell its products to the end consumers. Through this solution firms tend to obtain a widespread distribution at a lower cost. This model is characterized by a low degree of control over distribution channels and also by weak relations with its distributors.

In addition to the Directly Operated Stores (DOS), there are four other main distribution channels in the luxury goods industry: Franchise, Wholesale distribution, Agents and Licenses.

169 André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Prog.

Figure 29. Channels differ in the degree of control, capital requirement and profitability

	Control	Capital required	Profitability
DOS	High	High	Low
Franchise			
Wholesale Distribution			
Agents			
License	Low	Low	High

Source: André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Prog.

The great relevance of this strategic dimension is also confirmed by an interesting empirical research conducted in the Italian luxury fashion sector by the Centre of Excellence in Supply Chain Management of Politecnico di Milano, named Supply Network strategy (Brun et al. 2005)[170]. This study - based on semi-structured interview to owners and top management of twelve Italian luxury fashion companies – developed a framework model focused on critical strategic areas in the strategy definition process of luxury fashion firms. All companies involved in the survey have universally recognized that the downstream integration is a very critical aspect for success in the luxury fashion industry.

This critical relevance of distribution for luxury goods explains the increasing trend of owning and controlling the distribution channels over the last years. The rationale behind this trend is the perceived need of most of luxury companies to have a better control of their own brand, offering directly the product to customers and bypassing any kind of wholesaler or distributor.

During the 1980s and 1990s companies often delegated the sell to third parties, able to ensure a broader availability of the product. However, by this way, the brand image was diluted for often uncontrolled discount policy applied by the retailers and a wider diffusion of the product.

Over the last years, luxury firms aimed at regaining control of the distribution channels, through the acquisitions of franchises and the reduction of wholesales and duty free. However, the strategic choice of integrating the whole distribution can be rewarding in periods of high growth, but can be extremely risky in downturns, as the operating and the business risk is much higher in the case of full integration (higher risks associated with the inventory management, the leasing/financing commitments and the rigidity of the cost structure). Probably a mix between the different distribution channels is generally more appropriate.

[170] Brun A., Caniato F., Caridi M., Castelli C., Miragliotta G., Ronchi S., Sianesi A., Spina G., Logistics and supply chain management in luxury fashion retail: empirical investigation of Italian firms, Politecnico di Milano, Department of management, Economics and Industrial Engineering.

4.3 Strategic analysis of two clusters of firms: large group affiliated brands and independent players

4.3.1 The bigger the better for multi-brands luxury players?

As seen in the chapter concerning the consolidation curve, most industries experienced a strong concentration, with the dominance of the market by only a few players. The luxury industry - although mostly linked to the image of the independent family brands - is not an exception in the sectors' landscape.

As known, in the consolidation game many famous Italian brands were acquired by the four largest luxury groups which acted as consolidators over the last years. The world's leading luxury conglomerate LVMH has strongly expanded its luxury brand portfolio with the acquisitions of Bulgari, Loro Piana, Fendi, Acqua di Parma. Kering Group has acquired Bottega Veneta, Sergio Rossi, Brioni and Gucci Group.

As underlined in the KPMG luxury report[171], although the high value recognized to many of the Italian luxury brands, so far none of the Italian companies has been able to create a large luxury platform, as made by the French and Swiss groups. According to the CEO of Brioni (Kering Group), the creation of an Italian luxury conglomerate is highly unlikely in the next future, after the recent foreign acquisitions of many Italian prestigious brands. Among the reasons which have prevented the creation of an Italian large luxury group, according to the Deputy President of Fondazione Altagamma[172], there are the difficulties to acquire profitable firms when they are still family-owned. The French and the Swiss largest groups such as LVMH, Kering, Richemont and Swatch Group – in the first stage – have developed acquiring firms with a strong heritage when they were not so profitable and they were no longer managed by the founder's family but by external managers.

In the literature some scholars have expressed doubts regarding the validity of the increasing concentration in the luxury sectors. Kapferer (2012) assumed that the brand equity is strictly linked to its high symbolic power and that a change in its ownership can entail a risk of losing confidence in the brand's authenticity and inherited culture[173]. Rigby et al.(2006) argued that "*the usual benefits of being big – leverage with suppliers, shared marketing and administrative expenses, and high-volume, strategic customers – just do not seem to apply for most multibrand luxury players"*[174].

In addition, since many luxury groups have become listed companies, they are increasingly subject to market pressures in order to experience high revenues' growth and to maintain the equity brand high. This pressures can bring companies to exploit the luxury brands in an excessive way, increasing penetration and diffusion or through the introduction of so-called "accessible luxury" (Kapferer and Bastien, 2009[175]). In this respect., the former CEO of Gucci Group clearly stated "*We knew that at some stage we would have to become multi-*

[171] KPMG,2014, Le acquisizioni di investitori esteri nel fashion and luxury.

172 KPMG, 2014, Le acquisizioni di investitori esteri in Italia.

[173] Kapferer J.N., 2012, The new strategic brand management, New York.

[174] Rigby D.,D'Arpizio C.,Kamel M.A., 2006, How More Can Be Better, http://www.ft.com.

[175] Kapferer J.-N, Bastien V., 2009,: The Luxury Strategy: Break the Rules of Marketing to Build Luxury Brands, London.

brand. When you are a public company and you want to continue to create value for your shareholder, you have no choice. You cannot go downmarket because of the effect on margins and profitability"[176].

The recent wave of consolidation was driven by the willingness of many stand-alone companies to give up their autonomy and independence and by the search for synergies.

4.3.2 Strategies of developing luxury brands within luxury groups

In a M&A deal - on one hand - the brand joining the conglomerate has to add value to the group and - on the other hand - the group has to add value to the brand. The so called "parenting advantage" (Goold et al.) is given by those strategies, structures and processes through which the "*parent works through its businesses to create value* "[177]. For a luxury brand the main sources of this "parenting advantage" should be luxury brand development and sharing of group resources.

In order to ascertain that this is the case for large group affiliated brands, it is necessary to focus on how multi-business luxury groups organize their value chain, analyzing both support and primary activities. In particular, it should be proven if large conglomerates which dominate the luxury market have a distinctive competitive advantage with respect to the independent players and – if this is the case - in what it consists.

To answer to this question I will focus on the three largest luxury conglomerates – LVMH, Kering and Richemont – because all of them are multi-business firms (MBF). In fact, all three conglomerates own many different brands and offer different product categories (fashion & leather goods, watches & jewelry, fragrances & cosmetics, wines & spirits) within the luxury industry.

In order to analyze the different kind of synergies that can be generated within a luxury conglomerate, an interesting comparative case study was conducted by Ijaquané and Kapferer in 2012 ("Developing Luxury Brands Within Luxury Groups – Synergies Without Dilution?", 2012), focused on the strategies of three largest luxury conglomerates[178]. Their empirical analysis is based on many interviews - both semi-structured and open-ended interviews - made to the top management of all three investigated groups.

Since the issue of cost reduction is not so relevant in the luxury sector as in other sectors, the theoretical framework to which the authors make reference is the diversification theory. On the basis of this theory, the performance of multi-business companies is linked to their capacity to originate a corporate effect rather than an industry or business effect (Brush et al. 1999; Rumelt 1991[179]). According to Knoll (2008)[180], the corporate effect is the value created through vertical relationships between the corporate center and the

[176] Galbraith R., 2001, Multibrands: A Lucrative Strategy for the Luxury Italian Fashion, http://www.nytimes.com.
177 Goold M., Campbell A., Alexander M., 1994, The New Strategic Brand Management, New York.
[178] Ijaquané V., Kapferer J.N, 2012 Developing luxury brands within luxury groups – Synergies without dilution? , Management Review.St. Gallen.
[179] Brush T., Bromiley, P.,Hendrickx M., (1999), The Relative Influence of Industry and Corporation on Business Segment Performance, in: Strategic Management Journal, 20 (6).
Rumelt, R. (1991): How Much Does Industry Matter? , in: Strategic Management Journal, 12 (3).
180 Knoll S, 2008, Cross-business synergies: a typology of cross-businesses synergies and a midrange theory of continuous growth synergy realization, Wiesbaden.

businesses and the horizontal relationships between the businesses[181]. Another goal pursued by large conglomerates is the search for synergies[182]. Synergies considered in this study are those identified by Knoll that are not only operational synergies, but also financial synergies, market power synergies, and corporate management synergies (as illustrated in figure 30), which stem from leveraging operational, financial, market power and corporate management resources, respectively, across the business.

Figure 30. Typologies of synergies within luxury conglomerates

Source: Ijaquané V., Kapferer J.N, 2012 Developing luxury brands within luxury groups – Synergies without dilution?, Management Review St. Gallen.

The main findings of the empirical research focused on the main three luxury conglomerates are:

1. **Operative synergies (efficiency and growth synergies)**. As expected, in the luxury industry this kind of synergies are not as important as in other consumer goods sectors. **However, it was proven that efficiency and growth synergies do exist and derive from the pooling of common resources**.

181 Goold M., Campbell A., Alexander M., 1994, The New Strategic Brand Management, New York.
182 As stated by Ijaquané and Kapferer "Synergy means that the combined return of two or more units together is greater than the sum of the returns of each unit individually".
Ijaquané V., Kapferer J.N, 2012 Developing luxury brands within luxury groups – Synergies without dilution?, Management Review .St. Gallen..

These resources can be of two types: resources required for support activities and resources required for production/primary activities.

In the luxury sector, while support activities of the Porter's value chain can usually be managed at central level without much concern for brand image, the production/primary activities related to different brands cannot be pooled without affecting the brand heritage and specific identity, which are essential in the mind of its customers.

This research founded that synergies related to support activities are systematically present and relevant in all three investigated conglomerates. The efficiency synergies can be generated in many fields, which differ across the different product categories (see Figure 31), such as purchasing in leather goods, sourcing and manufacturing in watches, the R&D in fragrance and cosmetics. In other words, cost savings can be obtained sharing costs related to functions not directly linked to the primary activities of the luxury value chain. Synergies can be generated at two different levels:

i) <u>Centralized support functions</u> for those kinds of operations which impact the whole brand. These functions operate as shared centralized services;
ii) <u>Regional support functions</u> for those operations impacting the brand in specific geographical areas.

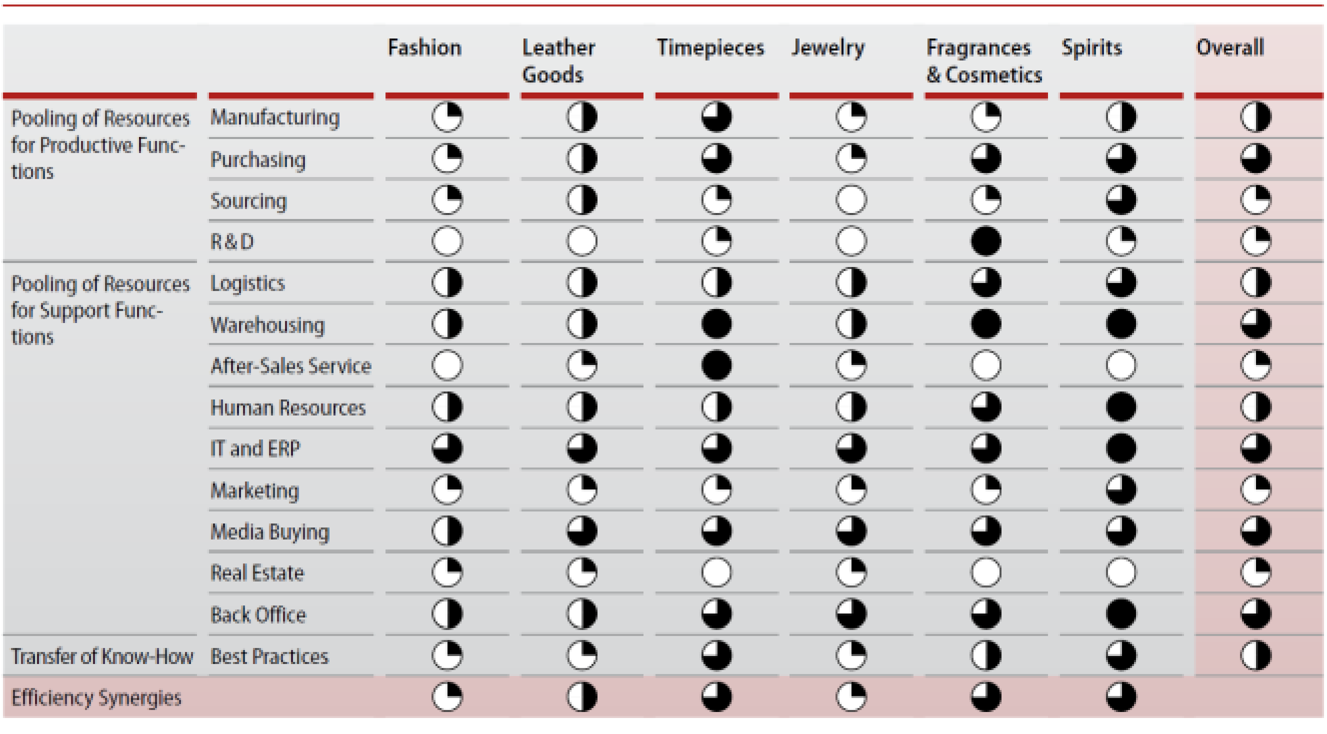
This last kind of synergies are most important for luxury brands because they allow to combine the efficiency of centralization with the need to rely on many local excellence for luxury productions (sourcing, manufacture, services after sales, etc...). Cost savings in regional support functions can mainly stem from warehousing, logistics, IT, human resources and media buying.

In particular, all the luxury product categories make use of common regional warehousing platforms. For timepieces brands, the pooling of both after sales services and warehousing is the main source of synergies related to support functions. These activities are concentrated in specific areas as luxury groups rely for such activities on common regional technical centers, usually located in Switzerland.

Not always synergies generated by some support activities can be pooled, because it depends on the level of integrations. Some functions such as IT, real estate, HR, after sales services are organized on a product category basis.

While efficiency synergies are usually generated through economies of scope deriving mainly from the pooling of common resources or from sharing best practices, growth or soft synergies usually stem from transfer of know-how. This practice enriches opportunities of large group affiliated brands in expanding their business, entering easily and quickly new markets or enlarging their product offering. In expanding their business, they can in fact rely on both the knowledge and network of relationships held by other brands in group's portfolio already operating in these markets or in these products categories. An example is given by the LVMH's access to the US market for fragrances thanks to its brands Bliss, Hard Candy, Urban Decay. Another good example relating to the extension of product offering - thanks to the transfer of know-how among different brands - are timepiece offered by fashion brands (Boucheron and Gucci, Richemont and Ralph Lauren, Tag Heuer and Louis Vuitton).

Figure 31. How luxury groups create added value



Source: Ijaquané V., Kapferer J.N, 2012 Developing luxury brands within luxury groups – Synergies without dilution?, Management Review St. Gallen.

Soft synergies can be generated – not only through the transfer of know-how – but also through the access to scarce resources. This access can relate both to raw materials (precious stones, specific artisan workshops, etc.), and specific technology, components or product.

Other typical soft synergies opportunities for non-luxury groups such as cross selling, cross-business bundling, etc… as well as shared marketing activities (e.g. joint image campaigns or joint customer loyalty programs) are not relevant or very marginal in the luxury industries, due to the great importance of sales and distribution activities for brand image and identity.

As expected, the two main spheres in which non-luxury groups usually generated synergies are not relevant in the luxury industry: creation and distribution. These primary activities of the value chain are critical for luxury brands and for their specific and exclusive identity, thus they are not organized to produce synergies but they are usually managed autonomously by each brand. In fact, the pooling of these activities is too risky for luxury brands and can seriously damage the value of the brand equity.

2. **Market power synergies.** This kind of synergies - according to Knoll (2008) typology of cross-business synergies[183] – are centered on advantages of MBFs stemming from conglomerate power that reduce business competition. Although these competitive aspects are under the strict control of anti-trust authorities, some advantages or opportunities can derive from a stronger market power:
    - large conglomerates - which have in their portfolio many luxury brands - can benefit from a stronger bargaining power with respect to their different stakeholders such as suppliers, wholesalers, department stores and media coverage;
    - in many BRIC (Brazil, Russia, India, China) countries – where luxury malls are sharply growing - large conglomerates such as LVMH, which owns more than sixty luxury brands, can establish on their own a luxury mall and make it grow.

    In the luxury industry, these synergies are not marginal but do not contribute significantly to the corporate advantage. Differently from other consumer goods industries, the luxury conglomerates do not tend to leverage on their market share to increase group revenues and to impose the new brands to their partners. As seen in the previous point, these practices can have negative effects on brand image and destroy the brand equity. Also the conglomerate power may have a negative reputational impact if the brands pushed forward do not reach their performing targets.

3. **Financial Synergies.** Although this kind of synergies are often ignored, it has proven that **these synergies are substantially relevant**. The empirical research conducted on the three largest conglomerates showed that all investigated groups have implemented a pooling of financial resources. This allows group affiliated brands to have easier access to credit lines, which can be a very crucial aspect when a brand aims at expanding its activities or reaching its very high break-even point. In addition, large conglomerates can usually grant much better financial conditions (lower interest rates) to their brands, because they are usually characterized by a lower risk profile as they are larger and more diversified than the single brand.

    In addition, the empirical research found that group affiliated brands can protect their activities' performance from currency fluctuations by centralizing currency hedging at the corporate level.

4. **Corporate management synergies.** One of the main finding of this empirical study is that this kind of synergies - stemming from corporate initiatives, HR management, corporate planning and control and, in general, all corporate capabilities - are extremely relevant in the luxury industry. In this sector, parent companies are able to add value to their affiliated brands due to their strong expertise in market intelligence, licensing and distribution. Conglomerates usually have strong knowledge and capabilities to strengthen luxury brands, even helping them to reach a better market position.

[183] 183 Knoll S, 2008, Cross-business synergies: a typology of cross-businesses synergies and a midrange theory of continuous growth synergy realization, Wiesbaden

Moreover, from this study it emerged also that large luxury groups are able to turn ailing brands in profitable ones through a change management. **A very critical driver of value creation for multi-brand luxury companies is the managements of talents**. Large groups are able to offer many more development paths across their brands than most single brand companies. **The HR capability to attract and retain talents is a major difference between large groups and family-owned companies.** Another important advantage of conglomerates is the opportunity for their executive management to share high-level best practices and ideas through their internal *maison* and universities (e.g., LVMH House in London) and then strategically employ them in key managerial positions across the different brands. This conglomerate's advantage is very crucial since key good managers are a scarce resource in the luxury industry. In fact, they should have excellent commercial and financial skills, a full understanding of the product and the ability to manage the brand creative talents.

Summing up, synergies in the luxury industry – characterized by high margins and by the exclusivity of brand image and identity - are not much related to costs reductions. The search for synergies should be carried out with extremely cautious in this sector, given the potential negative drawbacks for luxury brands. However, the empirical case study by Ijaquané and Kapferer has proven that efficiency and growth synergies do exist and arise from the pooling of common resources related to support activities. This kinds of synergies are systematically present and relevant in all the three investigated conglomerates.

Particularly important for luxury companies are financial synergies and synergies related to the knowledge sharing and the management of talents, two main strengths that large conglomerates can leverage to outperform their competitors on a long term basis.

All activities regarding creation and distribution which impact on customers' perceptions have limited synergies potential. This is confirmed by the fact that each brand have their own designer and try to expand directly their operated stores.

For what concerns primary activities, usually large conglomerates are more vertically integrated than smaller players, both upstream and downstream, also thanks to their financial firepower which allow them to sustain high investments to secure important suppliers and craftspeople, expand their directly operated stores or acquire joint venture partnerships.

In recent years, LVMH, Kering and Richemont have used, not only horizontal, but also vertical acquisitions (regarding both distribution channel and specialty parts suppliers) to become the largest luxury groups in the world. The companies are mostly focused to control and safeguard every key stage of the value chain to ensure the highest quality of their products and services, needed for luxury products.

In March 2013, Kering acquired a majority stake in France Croco, a firm company specialized in the sourcing, tanning, and processing of crocodile skins. The acquisition allows Kering to grant to its leather and footwear brands the high quality leather and the specific know-how needed for manufacturing their high-

margins products. To reinforce its already strong capabilities in the watch and jewelry category, Richemont acquired in 2012 a high-end manufacturer of exterior components for watches and a producer of semi-finished precious metal products. On the other hand, to strengthen control of key supply chains - allowing proprietary access to the best materials – LVMH acquired in 2012 the French second tannery, Les Tanneries Roux, a company specialized in smooth and supple calfskin leathers suitable for high-end leather goods products such as shoes, belts, and handbags.
By controlling the key stages of the value chain, companies are better able to manage and defend their carefully crafted brand heritage.

4.3.3 The performance of some Italian brands after being acquired by large conglomerates

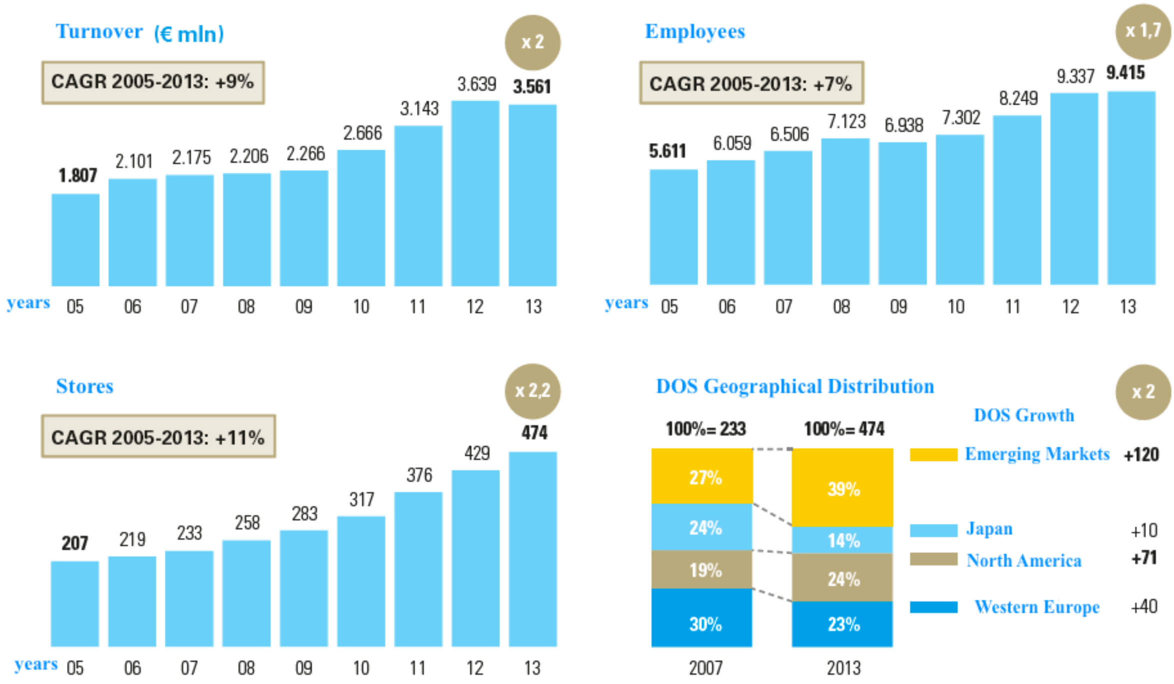
As seen in the previous paragraph, the main sources of the "parenting advantage" for a luxury group affiliated brand should be the luxury brand development and sharing of group resources. In order to empirically verify the development of a brand after being acquired by a large conglomerate, three real cases regarding three famous Italian luxury brands acquired by the French luxury conglomerates will be analyzed: Gucci, Bottega Veneta and Fendi. In particular, the purpose of this analysis is to investigate the performance of these brands in terms of growth of sales, of distribution network and employees in the period following their acquisitions.

The Gucci case

Kering entered in Gucci with a minority stake in 1999 and progressively has increased its participation in the company, reaching full control in 2004. After joining the French luxury conglomerate, the Gucci brand has experienced a great expansion at the international level. In the period 2005-2013, the opening of more than 200 directly operated stores - concentrated especially in the emerging markets and North America - has allowed the brand to double its sales (see Figure 32), registering a growth higher than the market average. The stronger expansion of its distribution network has been favored both by the knowledge and expertise of the Kering Group in the new markets and by the financial power of this large conglomerate.
In addition, the further commercial development of the brand and the strengthening of its competitive position in the luxury market have contributed to reinforce its organizational structure. The number of Gucci employees in the world has almost doubled in the observed period, passing from around 5,600 in 2005 to 9,400 in 2013.
At the same time, the Gucci brand has brought to Kering its excellent capabilities in digital marketing and e-commerce. As known, Gucci has been a pioneer in this field, setting the standard for the entire luxury market. Its brand's digital know-how is widely recognized in the industry and has been exploit by Kering to set-up in 2012 a Group e-commerce platform to provide the necessary technical competences to the other Groups' brands operating in its Couture & Leather Goods Division. The purpose is to strengthen the digital

strategy and the development of online business of all other brands which cannot rely on internal capabilities comparable to those of Gucci.

Figure 32. Performance of the Gucci brand in the period 2005-2013



Source: KPMG, 2014, Le acquisizioni di investitori esteri nel fashion and luxury.

Within the Kering Group, all the brand sites now exhibit mobile/tablet-optimized browsing, shared performance-measurement tools and a dedicated team of specialists to support all brands in improving site performance and customer satisfaction.

In this context, Kering has set out a cross-channel services strategy adapted to the specific features of each brand. The Group now benefits from several cross-channel services, such as online visibility of retail inventory (geo-localized for Gucci) and online sales, which are gradually being extended to in-store pickup and online reservation. In addition, the Group is encouraging its brands to explore innovative solutions, with pilot projects to test new technologies such as a new online fitting solution for ready-to-wear and shoes, and to share the results with all brands before making a Group-wide rollout. Moreover, in order to ultimately grant a whole omni-channel approach covering both bricks and mortar and online boutiques, the Kering Group is currently evaluating a large-scale project to establish a single shared customer database across distribution channels and to harmonize and optimize its information systems and operational processes.

The Group is structured and organized to bring more expertise, value and operational support to its brands, focusing on increasing return on capital employed by enhancing profit margins and optimizing capital allocation for investments as well as working capital.

Across all Group brands, a range of cross-business initiatives has been adopted with the support of Kering dedicated teams to optimize comparable-store sales performance. The purpose is to strengthen store

productivity through a series of upstream and downstream initiatives, such as: improving supply chain capacity and the efficiency of product allocation criteria by region and type; training sales staff in best practices for customer service; loyalty and experience; and developing Customer Relationship Management (CRM) and customers' tools. These cross-business initiatives aim to generate cost reductions, improve profitability and optimize capital employed. Additionally, the Group is reviewing its brands directly-operated store – in some cases even consolidating them if necessary – in order to grant a wider alignment of the allocation of investments to strict return guidelines. These initiatives will also be supplemented by the realisation of additional revenue and cost synergies, especially in terms of sourcing, production and logistics.
Complementing this efforts, Kering is focused on improving its management of talent, developing a Kering Leadership Model to allow its employees to acquire leader capabilities, to share a management culture and language centered on four cardinal points: i) Create with a vision; ii) Drive and deliver; iii) Engage with all; and iv) Build from heritage to legacy. Many training courses are offered to all managers around the world, particularly to support the fast-growing brands. Kering offers to the company's managers an International Talent Development Program in order to reinforce their strengths and develop their skills.
In line with the most important findings of the study on synergies generated by large conglomerate for the brands which joined it[184], the Kering Group is mainly focused on offering to its brands some centralized services regarding particularly support activities and to exploit growth synergies through transfer of know-how and share of best practices within the group.
Concerning the so-called primary activities, the Group aims at preserving the exclusive characteristics of its brands, leaving to the management of each brand the necessary autonomy in implementing concrete action plans at brand level. In early 2015 Gucci, soon-to-be 100 year old, started a major transformation program to renew its creative vein, organization and collections, confirming the great ability of the brand in reinventing itself and remaining the vanguard of the worldwide Luxury industry"[185].

The Bottega Veneta case

The Bottega Veneta brand was acquired by the Kering Group in 2001. This acquisition is one of the best examples of the how the membership of a small but prestigious luxury brand to a large group can create high value through its further development.
Bottega Veneta was a small company when it joined the Kering Group, with a turnover of only €160 million in 2005. In only eight years the group affiliated brand was able to reach an amount of revenue higher than one billion of euro: the compound annual growth rate (CAGR) over the 2005-2013 period was higher than 25%. To this growth has contributed the strong expansion of its distribution network at a global level, favored by the financial strength and luxury expertise typical of a large conglomerate. Through its

184 Ijaquané V., Kapferer J.N, 2012 Developing luxury brands within luxury groups – Synergies without dilution?, Management Review St. Gallen.
185 Kering Group, 2015, Kering Annual Report.

worldwide expansion, Bottega Veneta has consolidated its presence in emerging markets, without compromising its investments in mature markets, such as the US and West Europe.

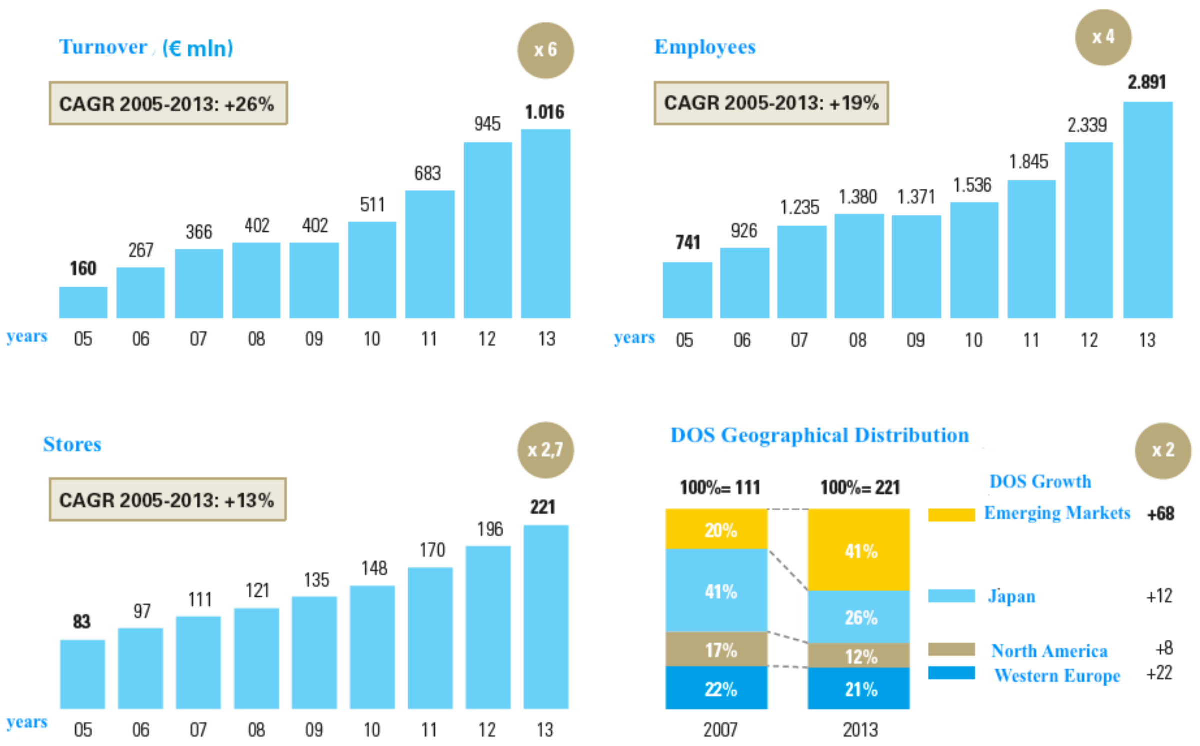
It is evident that the smaller is the luxury brand acquired, the higher is the potential development that a large group can ensure to its affiliated brand, granting solid financial resources, huge expertise, great capabilities in sharing best practices and in management both creative and executive talents.

Over the observed period, the DOS increased from 111 in 2005 to 221 in 2013 and the number of employees in the world has grown from 740 to around 2,900.

Founded in 1966, Bottega Veneta has evolved over the years from a leather goods House – made famous through its distinctive, crosshatched design (named "*intrecciato*") - into an absolute luxury Lifestyle brand by expanding its product range, always respecting the aesthetic characteristic of the brand and customers' desire. Bottega Veneta now offers a wide range of products, including leather goods (bags, small leather goods and a full luggage collection), ready-to-wear, shoes, jewelry, furniture and other products.

Over the years, the brand has developed collaborations with different partners who have brought their specific know-how and craftsmanship to some of its product categories, through license agreements (i.e. Coty Prestige for fragrances) and supply partnerships (i.e. Poltrona Frau for seating, Kering Eyewear for eyewear).

Figure 33. Performance of Bottega Veneta brand in the period 2005-2013



Source: KPMG,2014, Le acquisizioni di investitori esteri nel fashion and luxury.

Bottega Veneta's products are distributed mainly through a network of directly-operated stores, complemented by exclusive franchise stores and strictly-selected department. Throughout 2015, Bottega Veneta continued to pursue selective store openings, bringing its total network up to 251, compared to 236 at the end of 2014 (221 in 2013). In addition, its products are now available through the brand's online store in 50 countries.

Thanks to the strong development of the brand after its acquisition by Kering in 2001, Bottega Veneta is now positioned at the top of the luxury pyramid, in competition with a very limited number of luxury brands. The current strategy of the brand aims to further bolster Bottega Veneta's position as a high-end and exclusive luxury lifestyle brand, ensuring consistency and continuity in order to maintain its trait of exclusivity in the industry.

The objective is to grow throughout all product categories such as shoes, ready-to-wear, jewelry and eyewear – seen in the past only as merely complementing to Bottega Veneta offering - and to reach for them also the same standing as the core leather goods business. The brand will continue to be focused on the further strengthening of the execution of retail excellence through further reinforcement of the best practices already implemented at worldwide level. Kering is aware that granting the best luxury experience in stores is key to maintaining the uniqueness of the brand and achieving its long-term targets.

Despite being part of a foreign large conglomerate, the brand continues to be strongly committed to ensure the future of Italian know-how and continue the artisanal tradition of the Veneto region, where its story has started. The brand supported the creation of three cooperative of artisans specialized in *intrecciato* leather in three small Italian towns. In addition, La Scuola dei Maestri Pellettieri di Bottega Veneta, located within the company's Atelier in Montebello Vicentino, has started in January 2015 a collaboration with the University IUAV of Venice to create a three month post-graduate level course in advanced handbag design and product development.

The Fendi case

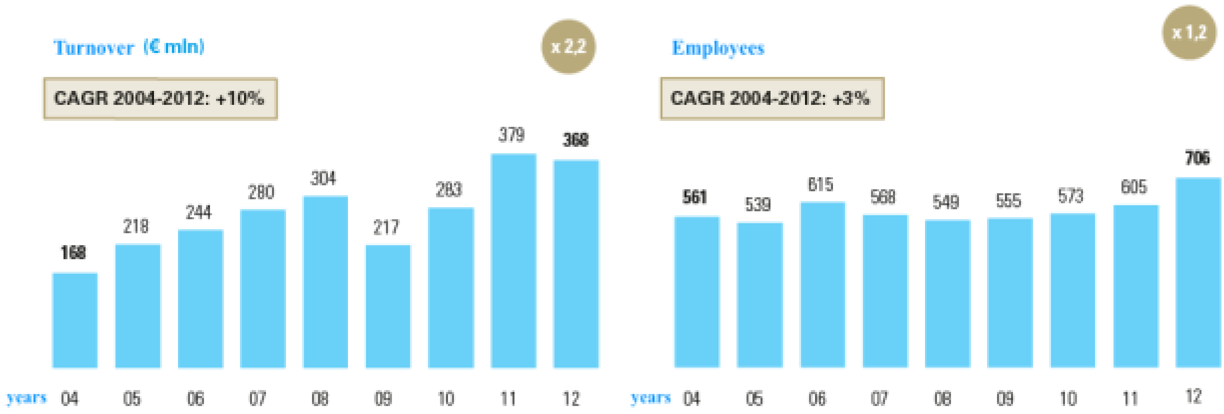
The Italian luxury brand Fendi – renowned for its furs and leather accessories - was acquired by the LVMH conglomerate in 2000.

The brand - founded in 1925 – was famous for its exquisite craftsmanship and innovative design due to its famous German designer Karl Lagerfiled, who was able to completely revolutionized the treatment of fur, turning it into the lush, soft and sumptuous material that is known in fashion today. Over time the House enlarged the offering of its products, by including timepieces, completely handmade handbags (Selleria) and other products such as furniture.

After the acquisition by LVMH, the Fendi turnover has more than doubled over the considered period. It experienced a remarkable compound annual growth rate (CAGR) over the 2005-2013 registering an increase

of 10%. Today its products are sold in 35 different countries through 190 point of sales, including brand stores and multi brand department store.
In 2014 the brand has acquired the Taramax watches, pursuing both an image return and a further consolidation of its turnover.
Over the years, Fendi has benefited from making part of a large conglomerate as LVMH, leader in the fashion and leather goods, thanks to its excellent expertise, huge scale and first mover advantage. As in recent years, the main driver of the luxury market growth is represented by emerging markets: LVMH is in the best position to exploit this opportunity of growing. First-mover advantage in key emerging markets should allow LVMH to speed up the development in the area of its brands as well Louis Vuitton and Fendi.

Figure 34. Performance of Fendi brand in the period 2005-2013



Source:KPMG,2014, Le acquisizioni di investitori esteri nel fashion and luxury.

In addition, the LVMH Group – due to its strong financial strength originated by high cash flow – is able to grant to its brands a large amount of resources for advertising with respect to the other competitors.
Concerning support activities, the Group aims at creating synergies by leveraging its Houses - always respecting individual entities – and by sharing resources on a Group scale. Regarding primary activities (sourcing/manufacture/marketing/distribution), LVMH has developed an operating model based on decentralized organization. The Group's structure and operating principles ensure that the Houses within their portfolio are both autonomous and responsive.
Over the recent years, Fendi showed excellent momentum across all business categories, with especially strong demand for its iconic Selleria and Peekaboo leather goods lines. The year 2015 has seen several important events such as the inauguration of the new headquarters at the Palazzo della Civiltà Italiana, the celebration of 50 years of creative collaboration with Karl Lagerfeld, and the reopening of the Palazzo Fendi in the heart of Rome.
In LVMH and Fendi strategy, innovation is a key driver and in 2016 the brand plans to launch new products and to continue to strengthen its distribution network. The Rome-based Fashion House will continue its expansion and new stores will be opened in the downtown areas of key cities and in new markets.

Summing up, in all three case examined – Gucci, Bottega Veneta e Fendi - the performance of the Italian luxury brands after their acquisition by large foreign groups has been very positive in terms of brand development. The turnover of the analyzed brands experienced a strong increase in all three cases in the period 2005-20013, due to the expansion of their product offering and to the global development of their distribution network. Both strategies have been sustained by the financial power of large conglomerates and their strong expertise, along with the ability to exploit knowledge sharing and best practices across all their brands. A key driver of growth is also given by the great ability of large groups to manage their talents, offering them a lot of development paths and training courses.

4.3.4 The Strategies of Independent players

In this section of the dissertation I will analyze the strategic implication concerning supply chain management for Italian luxury companies that are still independent and are not part of a large conglomerate, as opposed to Gucci, Bulgari, Bottega Veneta, Fendi and many other famous Italian brands. Most of the independent or pure players are family-owned (or family- controlled), with highly-concentrated ownership, usually managed (in the first generation, and sometimes in the second generation) - by the founders and other family members.

Academic studies and experiences from many companies all show that a certain degree of family ownership/control provides positive benefits to the family business and its shareholders[186]. In fact, family businesses can generate value for all shareholders, based on several factors, such as long-term perspective in decision-making; ability to react rapidly to changing market circumstances; strong commitment of family management to their company, providing continuity in the way the business is run.

Even if family businesses are recognized as a valuable asset, it is also widely recognized in the economic literature, that family ownership entails also some weaknesses related to the difficulties to fund growth attracting equity, also because of the will of the founder to not give up partial or total control to external shareholders. The higher risks linked to a higher ownership concentration can drive away additional sources of finance, limiting the firm' growth. In addition, this kind of companies faces the challenge of attracting good managers and specialists and usually has even more difficulties in retaining such qualified professionals. The relationship between family/managers and non-family managers or professionals is not easy and should be carefully built to ensure a well-functioning of the company's governance[187].

For the reasons aforementioned, there are usually more difficulties to acquire profitable firms when they are still family-owned. Many famous Italian brands have been acquired by foreign groups when they were no longer managed by the founder family but by external managers (i.e. Gucci).

[186] Feffer D, Governance Challenges for Family-owned Businesses, in Practical Guide to Corporate Governance (Chapter 5).
187 Feffer D, Governance Challenges for Family-owned Businesses, in Practical Guide to Corporate Governance (Chapter 5).

Some examples of successfully Italian luxury companies family-owned or family-controlled which are still independent are Prada (€3.5 billion of sales in 2014), Armani (€ 2.5 billion in 2014), Ferragamo (€ 1.3 billions), D&G (€ 1 billion), Tod's (€0.96 billion), Cucinelli (€0.428 billion).

The Top-15 Italian luxury independent companies reach an amount of sales of €27.8 billion, comparable in term of size with one of the big conglomerate[188]. The aggregate of Top-15 has an average number of employees equal to 176,900. Most of its sales are realized out of Europe (56%), mainly in Asian countries.

Before going in more details into the strategic analysis of the supply chain management, there is a major factor that must be taken into account concerning the Italian luxury landscape: when dealing with Italian independent brands, most of the times we are analyzing activities for a mono-brand business (i.e. Ferragamo, Armani, Cucinelli) or related to only some few brands such as Prada (with the brands Prada, Miu Miu, Church's, Car shoes) and Tod's (Tod's, Hogan, Fay), not comparable with the huge number of brands belonging to the large conglomerates (more than 60 for LVMH). Some of these Italian luxury firms are listed companies such as Prada, Ferragamo, Tod's and Cucinelli. Moreover, most of the Italian independent luxury are specialized in fashion and leather goods.

In order to identify the main strategies pursued by the Italian independent companies, my analysis will be based mainly on an empirical research developed by the Politecnico of Milan: the "Logistic and Supply Chain Management in Luxury Fashion Retail: empirical investigation of Italian firms"[189]. This analysis has the aim to evaluate the extent to which supply chain strategies have an impact on the success of luxury firms. Information for the study, which focuses on Italian fashion brands, was gathered through semi-structured interviews with owners and general managers (for small firms) and top managers (for larger firms) and documentary analysis. The firms investigated are Italian fashion manufacturers with a global presence which are now facing the challenge of developing supply chain strategies to compete globally. In order to be eligible for the sample, firms analyzed in this study have all the following characteristics:

1. have an international profile, with a presence in the key fashion capitals;
2. have been established in the fashion business for several years;
3. sell their products in two or more continents;
4. have experienced positive economic performance in the past years, and thus, can be considered as examples of good and effective management.

Furthermore, the sample is heterogeneous in terms of firm size, including large companies (such as Prada and Armani), middle-sized firms (Tod's and Versace) and small enterprises (among which Marinella).[190] In such a way, the sample is representative of the current composition of the Italian fashion luxury market.

188 Mediobanca, 2015, Top15 Moda Italia e aziende moda Italia: 2010-2014 e primi nove mesi del 2015.

189 Brun A., Caniato F., Caridi M., Castelli C., Miragliotta G., Ronchi S., Sianesi A., Spina G., Logistics and supply chain management in luxury fashion retail: empirical investigation of Italian firms, Politecnico di Milano, Department of management, Economics and Industrial Engineering.

190 Brun A., Caniato F., Caridi M., Castelli C., Miragliotta G., Ronchi S., Sianesi A., Spina G., Logistics and supply chain management in luxury fashion retail: empirical investigation of Italian firms, Politecnico di Milano, Department of management, Economics and Industrial Engineering.

The analysis - developed through a series of interviews to the management of the involved companies – aimed at identifying the critical success factors of their business and assessing the strategic managerial choices of their supply chain.

According to the study, the critical success factors considered most relevant by the investigated companies in their business are:

1. Product quality: both in terms of the superior manufacturing quality and in terms of product compliance with the companies' standard.
2. Style and design: in addition to the premium quality, luxury products should be able to convey emotions in the consumers.
3. Country of origin: importance of the label 'Made in Italy' which sometimes may increase the value perceived by customers.
4. Emotional appeal: considered both in terms of the service level and in terms of supporting customers in the emotional elements of the shopping experience.
5. Brand reputation: as expected, all brand related aspects are particularly critical for fashion/luxury products.
6. Creating a lifestyle: identification of both the product and the shopping experience with the values conveyed by the brand.

It is important to observe that none of the companies interviewed include costs among their critical success factor.

The main findings concerning supply chain configuration (see Table 5) – and in particular the three macro-activities sourcing, manufacturing and retailing - in the luxury segment of the Italian fashion industry are the following:

1) **the crucial relevance of keeping in house the core competencies related to the creation/design phase**, which more than other value chain phases affect the style and the aesthetic characteristics of the luxury product. For this reason, all investigated firms rely on a qualified internal design team – that often collaborates with external designers – in order to create products consistent with the brand image and customers' desires. As seen in the previous paragraphs, the activities related to the creation/design phase are considered critical, also for brands belonging to large conglomerate, for their exclusive identity and thus, are managed autonomously by each brand (they are not organized to produce synergies).

Table 5. Supply chain configuration for the analyzed companies (*)

Case study	Sourcing choices	Suppliers (localization)	Production (localization)	Retailing
1	Co-design with suppliers also from other industries Long term partnership Vendor selection based on quality	Consumables (Italy and abroad) Fabrics (Italy) Accessories (Italy)	Cutting: in house. Outsourcing of labor-intensive phases (Italy) Coordination through structured contracts and informal processes Flexibility through overtime Internal quality control	Training and support to sellers Downstream integration: mono-brand boutiques. No intermediaries Multi-brand shops Department store corners **Worldwide**
2	Co-design with outsourcers Long term partnership. Parallel sourcing. Relationship with second-tier suppliers	Leather and shoe components (Italy)	Outsourcing (Italy) Reserving upstream capacity and stock Internal quality control	Exclusive locations Selected multi-brand shops No intermediaries **Europe, USA**
3	Vendor selection based on quality and reliability	Leather (Italy)	Inside (Italy)	Multi-brand shops Department stores **Europe, USA, Japan**
4	Co-design with outsourcers. Vendor selection based on experience Reserving upstream material stock.	Raw material (abroad) Cashmere thread (Italy)	Cashmere products: in house. Clothes: outsourcing (Italy) Combine tradition and technology	Downstream integration: company owned boutiques No intermediaries when possible Exclusive locations **Worldwide**
5	Vendor selection based on quality and flexibility Relationship with second-tier suppliers	Leather and accessories (Italy)	Outsourcing to specialized companies (Italy) Coordination of supply and outsourcing network	Downstream integration: mono-brand boutiques. No intermediaries Retailing system redesign **Worldwide**
6	Vendor selection based on quality Parallel sourcing Long term partnership	Leather (Italy) Fabrics (Abroad) Special components (Italy)	In house manufacturing (Italy and abroad) Tracking of logistics transactions	Introducing mono-brand boutiques No intermediaries when possible Multi-brand shops **Worldwide**
7	Co-design Parallel sourcing Low cost countries for fabric items	Leather (Italy) Fabrics (Italy and abroad)	Outsourcing (Italy and abroad) Tracking of logistic transactions. Supply Chain Key Performance Indicators (KPI) system.	Downstream integration: company-owned boutiques Retailing system redesign Department stores **Worldwide**
8	Parallel sourcing Long term partnership	Leather (Italy)	In house Outsourcing of labor intensive phases (Italy) Reserve upstream capacity and stock	Downstream integration: mono-brand boutiques No intermediaries Exclusive locations Department store corners **Worldwide**
9	Parallel sourcing Long term partnership. Co-branding with branded suppliers Relationship with second-tier suppliers	Leather (Italy) Special components (specific countries)	In house Outsourcing to specialized companies (Italy). Coordination of the supply and outsourcing network. Internal quality control.	Downstream integration: mono-brand boutiques. No intermediaries Exclusive locations Department stores **Worldwide**
10	Materials sourced in Italy (high quality). Labor sourced in low	Leather (Italy) Other components (Abroad)	Abroad Logistic effectiveness. Tracking of logistic	Delivery priority to mono-brand shops Market penetration

	cost countries		transactions	through specialized and non specialized shops **Worldwide**
11	Materials sourced in Italy (high quality). Vendor selected on quality and reliability Internal quality control	Leather (Italy) Special components (specific countries)	In house Outsourcing to specialized companies (Italy for high end lines, Romania for entry level lines)	Delivery priority to leading customers and flagship stores. Exclusive locations. No intermediaries Retailing system redesign Customized packaging **Worldwide**

2) *(*) I have excluded from the sample the company N. 12 because it was Gucci that has been acquired by the LMVH Group.*
3) *Source:Brun A., Caniato F., Caridi M., Castelli C., Miragliotta G., Ronchi S., Sianesi A., Spina G., Logistics and supply chain management in luxury fashion retail: empirical investigation of Italian firms, Politecnico di Milano, Department of management, Economics and Industrial Engineering.*

2) **the most critical production phases for all companies in the sample should be kept in house, while only the non-critical and most labor intensive phases can be outsourced**. An example is given by one of the companies analyzed which kept in house cashmere manufacturing, considered as the main brand product, while outsourced the production of clothing made by other type of textile (secondary product) to specialized companies. For firms operating in the leather sector, the cutting phase is perceived as critical and kept in house, while other phases (such as sewing) are outsourced.

3) **suppliers are carefully selected even for those activities that may be outsourced, and luxury companies usually exercise some kind of control over the processes, monitoring operations**. This control is extremely important in order to ensure that product characteristics are fully compliant with the desired quality level of the brand.
   In some cases, companies outsource all stages of manufacturing to a network of small workshops, often belonging to the same industrial district, which are completely dedicated to the specific luxury company' production. In this case, the luxury company carries out all the planning and procurement activities and transmit their orders to the different suppliers which operate as if running their own production department. In addition, since the label "made in Italy" is important as critical success factor, even when production activities are outsourced, they take place in Italy.

4) **while the upstream part of the value chain is usually characterized by different sourcing and manufacturing levels** (several tiers of suppliers and outsourcers), **the downstream part of the value chain is shorter**. The main distribution channels used by companies are mono-brand stores, partly owned and partly franchised, multi-brand-shops and department stores, carefully selected to display the products in proper ways, consistent with the company' guidelines. All companies expressed a wish for downstream integration, considered as critical for the success of a luxury company. They intend to strengthen their direct relationship with customers through the redesign of their distribution channels, creating a network of mono-brand store, both owned and franchised.

Another reason for which firms prefer a downstream integration is to contrast counterfeiting issues, having higher control on the distribution network.

For most of the companies analysed, since demand is fluctuating - influenced by fashion trend - **the supply chain flexibility is crucial in their strategy[191].** This explains why most of the companies prefer outsourcing some production phases to a large number of small workshops. In addition, specialized craftsman companies – which are widely diffused in Italy, in particular in some specific districts (such as leather district in Tuscany) - can easily grant the excellence in hand-made quality details required by luxury firms. However, as known, this strategic choice require a strict control on product quality to ensure that its characteristics are compliant with the brand's standard.

One of the best examples of "quasi- vertical integration strategy" (or "in-partnership buy" strategy) is the Italian brand Ferragamo (see Table 6). The company keeps in-house the management and organization of the most important stages of the value chain while outsourcing the entire production process to expert staff in external workshops.

The use of a broad network of expert and selected Italian manufacturers allows the company to ensure flexibility and efficiency in the production and logistic cycle of their operating model. In addition, the strict cooperation between Salvatore Ferragamo S.p.A. and the network of suppliers has allowed to preserve a high degree of control over the critical stages of the value chain for what concerns the production process.

As a matter of fact, the company implemented the "quasi-vertical integration strategy" - the intermediate strategy between the buy and make strategy which combines the benefits of the two approaches (higher control and lower investments) - thus outsourcing manufacturing processes to outside providers with which they have built strong and long lasting relationship. This grants them a high degree of involvement in the process, through the transfer of know-how, technical assistance and by granting the stability of orders. This model ensures a high degree of flexibility to the company, allowing to cope with an instable and unpredictable demand.

Other companies made the choice to take production mostly in house and partly outsourced to a network of external manufacturers (such as Prada or Tod's, see Table 6), in some cases differentiating between main products and secondary products. Other companies of smaller size made a choice closer to the pure "buy" strategy, without building strict relationships with outsourcers. However, some of the investigated companies are introducing some kind of collaboration programs in order to increase the level of integration with their first level of suppliers and improve coordination with outsourcers.

According to the Politecnico of Milan empirical analysis, in some cases the role of suppliers and outsourcers – specialized in different technology and materials - may be crucial also in terms of innovation and new product development, since often the products are co-designed.

[191] Brun A., Caniato F., Caridi M., Castelli C., Miragliotta G., Ronchi S., Sianesi A., Spina G., Logistics and supply chain management in luxury fashion retail: empirical investigation of Italian firms, Politecnico di Milano, Department of management, Economics and Industrial Engineering.

Table 6. Upstream control by the luxury companies: expressions and motives

Enterprise	**Group**	**Raw materials sourcing policy**	**Manufacturing control**	**Explanation provided by the company**
Armani	Armani	Outsourced	The company owns production plants for apparel, shoes, handbags, knit, denim, and children collection.	Quality control and know-how
Tod's	Della Valle Group	Outsourced	The company produces a large majority of its products (shoes, leather goods) in its own plants. Casual clothes, jewelry and sunglasses are outsourced.	Quality control, efficiency, brand prestige
Salvatore Ferragamo	Ferragamo	Outsourced (more than 450 suppliers)	For shoes, bags and ready to wear, the company relies on a network of small workshops, all located in Italy. It focuses on product development and quality control	Flexibility, efficiency
Prada	Prada	Mostly outsourced	Nine-in house divisions producing knit wear, ready-to-wear, belts, shoes, leather ready to wear, and handbags. Some are shared with Miu Miu, another brand of the Prada Group.	Control of production, know-how, production costs, flexibility and quality.

Source: Delpal F., 2012,Vertical Integration in Luxury Companies: Objectives and Effects, Institut Francais de la Mode.

Regarding distribution, the great relevance of this strategic dimension is confirmed by the companies interviewed that universally recognized that the downstream integration is a very critical aspect for success in the luxury fashion industry. All the companies involved intend to strengthen their direct relationship with customers through the redesign of their distribution channels, creating or enlarging a network of mono-brand stores, both owned and franchised.

Since the choice of integrating the whole distribution is characterized by a higher operative and business risk (therefore can be extremely risky in downturns, as rewarding in high growth period), a balanced mix between the different distribution channels is probably more appropriate[192]. It may be argued that it is better to have DOS in high end shopping districts, where the brand image control is key and rely on franchisees and agents in other less visible areas. In such a way, the company acquires a certain flexibility and at the same time transfer part of the operating and business risk.

Over the past years Prada has implemented a refocusing process of its distribution network too, strengthening in particular the two brands that represent the main portion of the Group's turnover: Prada and Miu Miu. Among the independent players, the largest companies such as Prada Group and Ferragamo were the ones with a more prominent increase of DOS[193], a strategy which allowed them to enjoy a higher volume of sales.

From the research emerged that over the recent years all companies have moved toward a greater control of the value chain both at upstream and downstream level.

After having analysed the main primary activities of the value chain (sourcing, manufacture, distribution), now the analysis will focus on the support activities and, in particular, on the ability of independent player to exploit synergies in managing their business.

The possibility of exploiting efficiency and growth synergies across the different brands or product categories are more limited with respect to brands belonging to the big conglomerates, considering that many independent players are mono-brand or manage only some few brands (Prada Group and Tod's) and, in some cases, are also mono-product. In this respect, the larger-sized independent companies – such as Prada which ranks the 15th position in the Top -100 luxury company at global level and owns four brands - have more room to exploit economies of scale and growth synergies with respect to smaller firms.

A study of INSEAD which aimed to compare performance, positioning and organizational structure between brands belonging to large conglomerates, such as LVMH, and independent players positioned on the same segments, such as Tod's, confirmed that the first strategic group is better positioned in terms of some distinctive competitive advantages related to: economies of scale and of scope, management quality and competitive business structure, research and development, access to financial resources, higher bargaining power with retailers and distributors world-wide, international expansion[194].

In an increasingly consolidated luxury goods industry, it is very difficult for a company to thrive as an independent player, unless the uniqueness and creativity of the brand is able to continuously manufacture successful products with the support of streamlined operational activities. This may apply only to some

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192 André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Prog.

193 PWC, 2012, Challenges and opportunities in the new luxury world: winners and strategic drivers.

194 [194]André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Prog.

luxury segments - such as the fashion market in which many Italian independent players operate - where the initial investments are not so high and synergies created by belonging to a large conglomerate are not so strong (such as spirit & wines, fragrance & cosmetics, timepieces; see figure 35).

The viability of an independent company development strategy is more uncommon and questionable in other luxury segments (i.e. wine & spirits, perfumes & cosmetic), which are highly capital intensive in order to foster new product development, global and powerful distribution and communication.

Figure 35. How luxury groups create value

		Fashion	Leather Goods	Timepieces	Jewelry	Fragrances & Cosmetics	Spirits	Overall
Pooling of Resources for Productive Functions	Manufacturing	◔	◑	◕	◔	◔	◑	◑
	Purchasing	◔	◑	◕	◔	◕	◕	◕
	Sourcing	◔	◑	◔	○	◔	◕	◔
	R&D	○	○	◔	○	●	◔	◔
Pooling of Resources for Support Functions	Logistics	◑	◑	◑	◑	◕	◕	◑
	Warehousing	◑	◑	●	◑	●	●	◕
	After-Sales Service	○	◔	●	◔	○	○	◔
	Human Resources	◑	◑	◑	◑	◕	●	◑
	IT and ERP	◕	◕	◕	◕	◕	●	◕
	Marketing	◔	◔	◔	◔	◔	◕	◔
	Media Buying	◑	◕	◕	◕	◕	◕	◕
	Real Estate	◔	◔	○	◔	○	○	◔
	Back Office	◑	◑	◕	◕	◕	●	◕
Transfer of Know-How	Best Practices	◔	◔	◕	◔	◑	◕	◑
Efficiency Synergies		◔	◑	◕	◔	◕	◕	

Source: Ijaquané V., Kapferer J.N, 2012 Developing luxury brands within luxury groups – Synergies without dilution?, Management Review St. Gallen.

Among the independent players, there are also successful example of mono-brand companies which have adopted a diversification strategy via brand stretch - developing under its portfolio several different product categories - in order to find other sources of revenues and reduce the overall business risk. Armani, one of the most famous independent players within the Italian fashion landscape, is an example of a mono-brand business which, through the implementation of a diversification strategy, has been extremely successful in becoming a multi-business company. For example, Armani operates in several market segments, some related to the core business of the company (such as Haute Couture, Giorgio Armani Privè, Armany X/Y) and others completely new in which the company entered (Armani Home and Armani Hotels and Resorts) through joint ventures or acquisitions. Both line and brand extensions are ways to reach new consumers who were not on the radar for the brand. In this way, Armani was able to increase its sales by leveraging the brand equity into new categories.

In the luxury industry there are three different ways for growth:

1) Extend and defend the core product category (Tod’s);
2) Build new product categories via brand stretch (Armani);
3) Extend brand portfolio (Prada).

Usually, the three stage of growth are subsequent, as usually brands aim first to extend and defend their core product category, then – if they continue to grow – to stretch the brand and successively – if they have adequate financial strength and rely on their management and integration skills – to develop a portfolio of brands[195].

An obstacle to the third way of growth for independent players can be their characteristic to be in most cases family-owned or family-controlled which limit their ability to attract new funds to finance further company's growth.

4.4 The luxury industry: strategies of group affiliated brands versus independent players

In this chapter, I analyzed the main strategies pursued in the luxury industry by two different types of strategic groups: companies owned by large conglomerates and independent players. I adopted the conceptual framework of Porter's value chain, as made by researches focused on the luxury and fashion industries (Bonetti and Schiavone, 2014; André et alt., 2002) in order to identify the strategic dimensions which characterize the luxury companies' conduct. However, unlike other studies, I have taken into account not only the primary activities of Porter's value chain, but also support activities. The rationale for this choice is that it is not possible to compare the policies of the two strategic groups without analyzing the entire value chain, including support functions that are usually consolidated in large groups. In fact, neglecting support activities would mean not to consider one of the potential element ensuring a competitive advantage to conglomerates.

This analysis drew from two empirical studies based on both semi-structured and open-ended interviews made to the top management and owners of the companies involved. For the first strategic group, the three largest luxury conglomerates at global level – LVMH, Kering and Richemont – have been investigated, for the second one, it has been examined an heterogeneous sample of independent companies of different size - which includes Prada, Armani, Tod's, Versace and other smaller companies, such as Marinella - that could be considered representative of the Italian luxury landscape, where most of the luxury firms are: (i) specialized in the fashion and leather segments; (ii) family-owned or family-controlled; (iii) in most cases, mono-brand business or managing only a few brands.

In addition - to verify the development of a brand after being acquired by a large conglomerate - three case studies have been analyzed, regarding three famous Italian luxury brands acquired by the French luxury conglomerates: Gucci, Bottega Veneta and Fendi. In particular, it was investigated in the period following their acquisitions (2005-2013) the performance of these brands in terms of sales growth, of distribution network and employees.

[195] André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Prog.

Before focusing on the main strategic differences between the two cluster of firms, I would like to highlight their similarities:

- none of the companies investigated featured costs among their critical success factors; this is consistent with the fact that in the luxury industry the issue of cost reduction is not relevant as in other sectors;
- all the companies belonging to the two strategic groups viewed as a priority the design stage of the value chain, which is mainly made in house (in some cases, for independent players, with the additional support of external designers). Furthermore, for brands belonging to large conglomerates, design activities are usually managed autonomously and present limited synergies;
- also distribution and, in particular, downstream integration were assessed as crucial for the success of a luxury brand, although some differences emerged with respect to the different degree of integration, higher for large conglomerates than for independent players. Since it is a critical phase, in large groups distribution is not organized to create synergies but it is managed separately by each brand;
- over the recent years, all companies of the two groups are moving toward a greater control of the value chain, both at the upstream and downstream level. Nevertheless, the intensity and the way through which this is made differ for the two strategic groups (and for large and small independent companies).

Concerning the primary activities of the value chain, from the analysis three strong differences emerged between the strategies of the two groups:

- **large conglomerates are more vertically integrated**, **especially at upstream level**, thanks also to their financial firepower, allowing them (i) to secure important suppliers and craftspeople, (ii) expand their directly operated stores and (iii) acquire joint venture partnerships. In recent years, LVMH, Kering and Richemont have used both horizontal and vertical integration to become the largest luxury group in the world;
- **most of the independent companies investigated**, specialized in fashion and leather goods, **consider the supply-chain flexibility a strategic factor**. This explains why most of the independent companies prefer outsourcing some production phases to small specialized workshops. In some cases, they realized a "**quasi-vertical integration**", building strong and long lasting relationships between the company and the outside suppliers, based on technical assistance and transfer of know-how. This model ensures a high degree of flexibility to independent players, allowing them to cope with an instable and unpredictable demand. In addition, "quasi-vertical integration" allows these companies to reach a greater degree of control on the supply chain, without requiring high capital investments and high operative risk as in the case of full integration. These firms need to be flexible

because they cannot rely on geographical and product diversification, which is one of the strengths of large conglomerates.

- although the search for synergies in the luxury sector must be conducted with caution (otherwise it could potentially damage the brand image and its integrity in the minds of its customers), **it was proven that – depending on the product category - there are many domains which can generate efficiency gains in multi-brand and multi-business group,** such as research and development in fragrances, purchasing in leather goods, sourcing and manufacturing in watches.

Although there are differences in the strategic way in which primary activities are managed, **the main competitive advantage that group affiliated brands have over independent players is the capacity to generate synergies from the support activities of the value chain**, by pooling different kind of resources (financial, HR, technology, market power, etc..). The value added brought by a conglomerate to an independent player may regard:

1. **Quality of management and competitive organizational structure**. All the largest conglomerates have strong capabilities in attracting and training the best talents. Large groups, such as LVMH and Kering, heavily invest in the development of their human resources, promoting mobility across the different business divisions and geographical areas and ensuring connections with universities and business schools. In addition, modern management techniques and organizational structures have often been brought by the conglomerate model to traditionally operating stores.
2. **Funding**: a specificity of the luxury conglomerate is the ability to have easier and cheaper access to credit lines, due to lower risk profiles. The pooling of huge financial resources allows conglomerates to act rapidly in their development strategies (i.e. reinvesting the funds in brands under development or restructuring or making M&A operations) and grant better funding conditions to the subsidiaries, favoring innovation and market reactivity.
3. **Higher bargaining power with retailers and distributors world-wide**: large conglomerates can benefit from a stronger bargaining power with respect to their different stakeholders (suppliers, distributors, media coverage, etc…). Moreover, large conglomerates such as LVMH – which owns more than 60 brands in its portfolio – have the power to establish on their own a luxury mall in new markets and make it grow.
4. **Economies of scale and scope**: surprising synergies brought by the conglomerate to a pure player are economies of scale and scope. Efficiency are primarily derived by IT, logistic, warehousing and media buying. Growth synergies are derived from transfer of know-how and access to scarce resources (in terms of raw materials and specific technology).

5. **International expansion**: a strong expertise in international expansion, in addition to relevant financial and managerial resources, can be brought by the conglomerate to each subsidiary, especially after the acquisition of a new company (i.e. Bottega Veneta, Fendi, Gucci).

As previously described, an independent player can benefit from the integration in a luxury conglomerate, thanks to the different competitive advantages brought by the conglomerate model to the single brand.

In order to prove the benefits brought by the membership of a pure player to a large luxury group, I analyzed three cases studies regarding three Italian famous luxury brands acquired by the French luxury conglomerates (Kering and LVMH): Gucci, Bottega Veneta and Fendi. All three cases examined show that after the acquisition sales, the distribution network and employees improved markedly. The turnover of the three brands experienced a substantial increase in 2005-2013, due to the expansion of their product offering and the global development of their distribution network. Both strategies have been sustained by the financial power and expertise of the parent conglomerates. A key driver of growth is also represented by the great ability of large groups to manage and train talents.

One of the best example of how a small brand can benefit from the integration in a large conglomerate is Bottega Veneta, that was only a small company when it joined the Kering Group (with a turnover of only €160 million in 2005) but has evolved over the years from a leather goods House – made famous through its distinctive, crosshatched design (named "*intrecciato*") - into an absolute luxury Lifestyle brand, with a turnover which exceeds one billion euros and a wide range of products.

It is evident that the smaller it is the independent brand acquired, the higher it is the potential development that a large group can ensure to its affiliated brand, granting solid financial resources, huge expertise, great capabilities in sharing best practices and in the management of both creative and executive talents.

For these reasons, excelling in the international expansion it is quite challenging for many luxury independent brands, while the large conglomerate is able to gather all the resources needed (funding, management, distribution networks) for the brand's development.

5. Conclusions

As seen in the previous chapters, the consolidation game is accelerating in the luxury industry. It seems that size is increasingly relevant in order to smooth the business cycles, to provide diversification, growth, synergies opportunities, and to allow for better vertical integration. Some analysts argue that a luxury business should be "*large enough to harbour several brands, and not be tempted to overexploit (and destroy) a single label. That means having a pipeline of brands and products "under development", and devoting considerable resources to old-fashioned "R&D"*[196].

In an increasingly challenging and globalized luxury environment, most of the world's famous brands belong to one of the "big four" luxury conglomerates: LVMH, Kering, Richemont and Swatch. As a matter of fact, the luxury market is highly concentrated: the economic concentration of the top 10 luxury goods companies is equal to more than 50% of the market. The four largest conglomerates - that own more than one hundred brands - dominate the market, keeping a constant pace of both horizontal and vertical acquisitions.

In this consolidation game, many independent players ended up being acquired by large luxury conglomerates. In the last years, most of the famous Italian luxury brands such as Gucci, Bottega Veneta, Fendi, Loro Piana and Bulgari, were acquired by large foreign groups. As stated by Hoffmann and Lecamp "*the world of luxury is harboring an endangered species: that of the independent companies*"[197].

In the luxury landscape, it is possible to identify two cluster of firms: companies owned by large conglomerates and independent players. I analyze the main strategies pursued by the two strategic groups, following the conceptual framework of Porter's value chain, as made by other researches focused on the luxury and fashion industries. However, unlike other studies, I take into account not only the primary activities of Porter's value chain, but also support activities. In fact, neglecting support activities in this strategic analysis would mean not to consider one of the potential element ensuring a competitive advantage to conglomerates.

This analysis draws from two empirical studies based on semi-structured and open-ended interviews made to the top management and owners of the companies involved. For the first strategic group, the three largest luxury conglomerates at global level – LVMH, Kering and Richemont – have been investigated; for the second, a heterogeneous sample of independent companies of different size has been examined. Such a sample includes Prada, Armani, Tod's, Versace and other smaller companies that could be considered representative of the Italian luxury landscape, where most of the luxury firms are: (i) specialized in the fashion and leather segments; (ii) family-owned or family-controlled; (iii) mono-brand business or managing only a few brands.

[196] The Economist, March 2002, Special Report on luxury Goods, Every cloud has a satin lining.

[197] Hoffmann J., Lecamp L., Independent Luxury - The four innovation strategies to endure in the consolidation jungle, Palgrave Macmillan,2015

Concerning the primary activities of the value chain, from the analysis three strong differences emerge between the strategies of the two groups:

- large conglomerates are more vertically integrated, especially at upstream level;
- most of the independent companies investigated consider supply-chain flexibility a strategic factor. These firms need to be flexible because they cannot rely on geographical and product diversification, which is one of the strengths of large conglomerates;
- multi-brand and multi-business group can generate efficiency-enhancing synergies, such as purchasing in leather goods or sourcing and manufacturing in watches.

Design and distribution are two important domains in which non-luxury groups generate synergies, the same does not occur for luxury firms. This is mainly due to the fact that these kind of activities - being strictly linked to the specificity of the brand image and experience – are not usually organized to produce synergies, but are managed autonomously by each brand to avoid damaging the brand equity.

Although there are differences in the strategic way in which primary activities are managed, the main competitive advantage that group affiliated brands have over independent players is the capacity to generate synergies, by pooling different kind of resources (financial, human resources, information technology, market power, etc). The key advantages brought by a large conglomerate to the single independent brand are: a cheaper cost of capital to finance huge investments needed for the brand's development (both in terms of product offering and of the international expansion); an increasing bargaining power with suppliers and distributors; lower cost of operations; growth synergies deriving from transfer of know-how and access to scarce resources.

In order to prove the benefits brought by the membership of a pure player to a large luxury group, I analyze three case studies regarding three famous Italian luxury brands acquired by the French luxury conglomerates (Kering and LVMH): Gucci, Bottega Veneta and Fendi. All three cases examined show that after the acquisition sales, the distribution network and employees improved markedly. The turnover of the three brands experienced a substantial increase in 2005-2013, due to the expansion of their product offering and the global development of their distribution network. Both strategies have been sustained by the financial power and expertise of the parent conglomerates. A key driver of growth is also represented by the great ability of large groups to manage and train talents.

In order to maximize the benefits of having a multi-brand and a multi-business activity, without negative impacts on the different brands, each conglomerate has to find the right balance between the search for synergies through centralization and the autonomy of the single brand. In this respect, an organized network of business branches can provide a powerful infrastructure and allocate shared resources to the different brands. In this case each brand or Maison can operate as a virtual company with its own Chief Executive Director and its own designer. It is essential that they maintain their autonomy within the large conglomerate. Corporate managers should take into account that in the luxury sector cross-synergies should be executed wisely and that, in this field, the rule “the more synergies the better”[198] does not hold.

Becoming a successful luxury goods firm - especially on a global scale - requires significant resources, knowledge and experience. Consolidation – essentially through the acquisition of many smaller luxury brands by large conglomerates – is not only the way for smaller companies to survive in the consolidation jungle but also the way of being able to grow and become a global luxury brand.

[198] Kapfner J., Ijaquane V, Developing luxury brands within luxury groups- synergies without dilution?

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LIBERA UNIVERSITÀ INTERNAZIONALE DEGLI STUDI SOCIALI

Department
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Corporate Strategies

THE LUXURY CONSOLIDATION JUNGLE: LARGE GROUP AFFILIATED BRANDS VERSUS INDEPENDENT PLAYERS (KINGS OF THE JUNGLE VS CODE BREAKERS)

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The luxury consolidation jungle: group affiliated brands versus independent players

The luxury consolidation jungle: group affiliated brands versus independent players

The topic of this dissertation is the evaluation of how strategic choices affect the performance of two strategic groups in the luxury industry: companies owned by conglomerates and independent players.

In the recent years many independent brands ended up being acquired by large luxury conglomerates that dominate the market, with a huge product offering and a strong international footprint. As stated by Hoffmann and Lecamp "*the world of luxury is harboring an endangered species: that of the independent companies*"[199].

It seems that size is increasingly relevant in order to smooth the business cycles, provide diversification and growth, and allow for deeper vertical integration. This analysis, focused on the different strategies of two clusters of firms - group affiliated brands and independent players - can help us clarify what is the competitive advantage of the conglomerate model and if it adds value to an independent company in case of acquisition.

Chapter 1

In the first chapter, I present a review of the economic literature on strategic group theory. The concept of "strategic groups" was introduced for the first time by Hunt in 1972 in order to give an explanation to the variance in performance within the same industry between groups of firms pursuing similar competitive strategies. Hunt coined the term "strategic group" to describe "*a group of firms within the industry that are highly symmetric with respect to cost structure, the degree of vertical integration, and the degree of product differentiation, formal organization, control systems, management rewards/punishments, and the personal views and preferences for various possible outcomes*" (Hunt, 1972)[200].

A central theme of the literature on strategic groups is that firm's performance is explained to a larger extent by the strategic group to which it belongs rather than by the idiosyncratic character of the individual firm[201].

Two schools emerged in the development of the strategic group theory: the Industrial Organization (IO) school, rooted in economics and developed mainly at Harvard University (which includes researches by Hunt, Porter, Oster, Caves and Porter and Newman) and the so-called Purdue School of Strategic Management (with the contributions by Hatten, Patton and Cool):

11. IO researchers adopt a multi-industry focus often based on one or only few variables to identify strategic groups. The variables most commonly selected are firm size (Porter, 1973), advertising (Oester, 1982) and relationships with other industries (Newman, 1973). This approach – rooted in the Structure-Conduct-Performance paradigm – usually relies on company-level data and different

[199] Hoffmann J., Lecamp L., Independent Luxury, Palgrave Macmillan, 2015.

[200] Hunt M.S., Competition in the major home appliance industry 1960-1970, unpublished doctoral dissertation, Harvard University, 1972.

[201] Cool, K., & Schendel, D. (1987). Strategic group formation & performance: the case of the U.S. pharmaceutical industry, Management Science.

performance indexes available in industry databases. A typical example of this stream of literature is the work by Porter that classified firms belonging to 43 different consumer industries in two strategic groups – leaders and followers – according to one strategic dimension: firm size.

12. in contrast to the IO approach, strategic management researches focus on a single industry and adopt a multivariate approach with many variables used as proxies for resource and scale commitments. Strategy in this approach is essentially industry/context specific and represents a pattern of choices which should take into account many elements such as available resources, the competitive position, management's risk attitude and industry structure. An example of this stream of literature is the work of Hatten (1974) for the US brewing industry, which identifies seven strategic groups using a multi-variable model relating performance (return on equity) to three manufacturing variables, three marketing variables and two structural variables.

The concept of strategic groups enriches the SCP paradigm and IO perspective, offering a convenient taxonomy to compare and to analyze different strategies of clusters of firms. There is still a debate in the literature about how strategic groups should be identified and the main difference in the numerous existing studies regards the strategic dimension used to classify groups. Some authors suggest to use a single variable such as size or advertising, others prefer to rely on a large set of variables.

Since strategic group analysis shows a high sensitivity to the variables adopted, an in depth knowledge of the industry is necessary to adequately specify the set of variables to be used in any strategic groups analysis that would accurately reflect firms' strategic choices.

Chapter 2

In order to fully understand the specific characteristics of the luxury industry, the sector in which I apply the strategic group theory, I analyze in Chapter 2 the peculiarities of this industry and its major trends over the recent years (vertical integration, consolidation, diversification and war for talents).

The worldwide luxury industry exceeded € 1,000 billion euros of sales in 2015, with a growth rate of 5% at constant exchange rates. The industry can be divided in ten different business segments: luxury cars (approximately 39% of the luxury market); personal luxury goods (24% of the luxury market); luxury hospitality (17%); fine wines and spirits (6%); fine food (4,3%); fine art (3,8%); designer furniture (3%); private jets (2%); yachts (0,7%); luxury cruises (0,2%). The focus of my analysis will be on the segment of personal luxury goods, which represents the core business of the entire luxury market and accounts for more than €250 billion in 2015. It is the second largest segment of the luxury market, after luxury cars.

The luxury industry is very peculiar, mostly due to the fact that it is characterized by intangibility more than any other sector. This industry is defined by three relevant characteristics:

1. *Firm size*. In the luxury industry firms are usually small-to medium sized enterprises with an impressive reputation. In this industry, economies of scales are reached by big conglomerates through large brand portfolios, made up of many small individual companies;
2. *Financial Structure*. A financial characteristic of all luxury enterprises is the very high breakeven to which they are subject. In the luxury market all brands, no matter how small, have to make high investments in any phase of the value chain in order to succeed. Every brand must be present worldwide and guarantee top quality in any stage. As soon as the brand is able to achieve sales above the breakeven level, a large part of the margins becomes profits since margins are very high.
   Another industry's characteristic regards the capability of many luxury companies that have been losing money for many years to survive as part of a conglomerate, thanks to its economic and financial strength. This is due to the strong brand value and awareness for customers.
3. *Time frame*. In the luxury industry the most important strategic decisions have a long-term impact. It takes much time to build a successful brand or to modify the image of a brand because of its specific identity in the mind of consumers. In the luxury world, product launches require longer preparations and many more investments compared to non-luxury sectors.

Regarding the industry structure, at first glance it is an oligopoly dominated by the presence of a few large conglomerates which govern the market with no space for small independent players. Most of the world's leaders brands belong to one of the "big four" luxury conglomerates: LVMH, Kering, Richemont and Swatch. Majors players in the market are fighting for leadership, by increasing economies of scale and their international presence - especially in emerging markets located in Asia and the Middle East - and becoming more diversified, as well as more vertically integrated, than in the past.

The main trends observed in the industry over the last years are:

- Consolidation. The industry is moving more and more towards consolidation, through an increasing wave of mergers and acquisitions (M&A) driven by horizontal and vertical acquisitions. It seems that in the luxury industry size is becoming increasingly important in order to have the critical mass to be international, to exploit scale economies, to smooth the business cycle, to provide growth, synergies and diversification, as well as to secure suppliers through better vertical integration[202].

- Vertical integration. A company is said to be vertically integrated when it controls several successive stages of the production process of its product. Vertical integration can be of two types: upstream or downstream depending on the proximity to the final consumer. Through this practice large groups are able to strengthen the supply chain and have a greater control over the manufacturing process and the distribution process.

- Diversification. By this strategy, the major luxury companies try to exploit economies of scale and scope while also reducing the overall risk of their activities. Many luxury companies have evolved their portfolio

[202] André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Program.

from mono-segment to multi-segment and from mono-brand to multi-brand. The key luxury conglomerates such as LVMH, Kering and Richemont are example of multi-brand/multi-segments companies. Swatch Group is a large luxury group multi-brand/mono segment as well as Estée Lauder.

- **War for talents**. Since the creative talent is very crucial for the development of the luxury business, it is critical for industry players to be able to attract and retain the best talents[203]. According to the Luxury Industry Specialists of KPMG, the large groups are more able than small-medium sized companies to attract and retain talents, because they can ensure a more dynamic management of human resources, through intra-group mobility, and more knowledge sharing among the different brands belonging to the group[204].

Chapter 3

After having analyzed the main features of the luxury industry, I present in the third chapter theoretical models which try and explain the pattern of industry consolidation, focusing in particular on the Merger Endgame model. The aim is to understand what position in the consolidation curve the luxury industry occupies.

The Merger Endgame model is based on an extensive empirical research conducted by the Global management consulting firm A.T. Kearney, showing that most industries follow a predictable consolidation life cycle similar to an S-curve, named the Endgame Curve. This model can be described as a firms' race for market dominance, an endgame toward an endpoint that is the final stage of the consolidation process. Most industries follow a predictable consolidation life cycle going through four different stages:

1. **Stage 1 - Opening**. The first stage, Opening, typically begins with start-ups and it is usually characterized by an unending pace of innovation, countless opportunities and risks. In this stage, entry barriers are generally low and the three largest players usually hold a global market share between 10% and 30%.
2. **Stage 2 - Scale**. This stage is entirely focused on building scale, pushing the main players to expand both through organic growth and mergers & acquisitions. Major players start to emerge and the three largest companies usually hold a market share ranging from 15% to 45%.
3. **Stage 3 - Focus.** The focus stage is characterized by some megadeals and large-scale consolidation. In this phase, the top three players cover a market share between 35% and 70%. In this stage, the rules of the game are well known and only a disruptive innovation can cause significant changes.
4. **Stage 4 - Balance and Alliance**. The Balance and Alliance stage is a calmer phase, where further consolidation is highly unlikely. At this stage, the top three player control from 70% to 90% of the market. Because growth is more challenging (large companies have in fact already maximized their market penetration), large companies may establish alliances among each other.

[203] André C., Bertin S., Gautreau A., Pougnadoresse P., Sepulveda Scultz R., 2002, Can luxury goods conglomerates sustain above-normal returns? The Gucci Group case, Insead MBA Program.
204 KPMG, 2014, Le acquisizioni di investitori esteri in Italia.

According to the Endgame model, the long-term success of a company is strictly linked to the way it progresses through the stages of industry consolidation. For this reason, it is vital for a firm to understand at what point in the cycle their industry is. Along the S-curve, niche players are more and more at risk of becoming the target of acquisitions or being forced out of the market. As mature industries move toward consolidation, niche firms' strategies should try and be as much as possible forward-looking to anticipate new trends and tailored for each consolidation stage.

In the consolidation curve, the luxury sector should be positioned between the end of scale stage and the last two stages of the consolidation curve. The luxury market is highly concentrated: according to the 2016 Deloitte Luxury Report[205],, the revenues of the top 10 luxury companies account for approximately 51% of the Top 100 luxury companies' revenues.

Chapter 4

In the previous chapters, I focused both on the strategic groups' literature and on the analysis of the main features and trends of the luxury industry in the consolidation curve. In the fourth and conclusive chapter, I analyze the main strategies pursued by two different types of strategic groups: companies owned by large conglomerates and independent players. To identify the strategic dimensions characterizing the conduct of luxury companies, I adopt the conceptual framework of Porter's value chain, taking into account both primary and support activities. The rational for this choice is that it is not possible to compare the policies of the two strategic groups without analyzing the entire value chain, including support functions, which are usually consolidated in large groups. In fact, neglecting support activities would mean not to consider one of the potential element ensuring a competitive advantage to conglomerates.

This analysis draws from two empirical studies based on semi-structured and open-ended interviews made to the top management and owners of the companies involved. For the first strategic group, the three largest luxury conglomerates at global level – LVMH, Kering and Richemont – have been investigated; for the second, a heterogeneous sample of independent companies of different size has been examined. Such a sample includes Prada, Armani, Tod's, Versace and other smaller companies that could be considered representative of the Italian luxury landscape, where most of the luxury firms are: (i) specialized in the fashion and leather segments; (ii) family-owned or family-controlled; (iii) mono-brand business or managing only a few brands.

Concerning the primary activities of the value chain, from the analysis three strong differences emerge between the strategies of the two groups:

- large conglomerates are more vertically integrated, especially at upstream level;
- most of the independent companies investigated, specialized in fashion and leather goods, consider supply-chain flexibility a strategic factor. These firms need to be flexible because they cannot rely on geographical and product diversification, which is one of the strengths of large conglomerates;

[205] Deloitte, 2014, Global power of luxury goods.

- multi-brand and multi-business group can generate efficiency-enhancing synergies, such as purchasing in leather goods or sourcing and manufacturing in watches.

Although there are differences in the strategic way in which primary activities are managed, **the main competitive advantage that group affiliated brands have over independent players is the capacity to generate synergies, by pooling different kind of resources** (financial, HR, technology, market power, etc..). The value added brought by a conglomerate to an independent player may regard:

6. **Quality of management and competitive organizational structure**: all the largest conglomerates have strong capabilities in attracting and training the best talents. Large groups heavily invest in the development of human resources, promoting mobility across business divisions and geographical areas and ensuring connections with universities and business schools.
7. **Funding**: a specificity of the luxury conglomerate is the ability to have easier and cheaper access to credit lines, due to lower risk profiles. The pooling of huge financial resources allows conglomerates to act rapidly in their development strategies and grant better funding conditions to their subsidiaries.
8. **Higher bargaining power with retailers and distributors world-wide.**
9. **Economies of scale and scope:** efficiency is primarily derived by IT, logistic, warehousing and media buying. Growth synergies are derived from transfer of know-how and access to scarce resources (in terms of raw materials and specific technology).
10. **Expertise in international expansion**.

In order to prove the benefits brought by the membership of a pure player to a large luxury group, I analyze three cases studies regarding three Italian famous luxury brands acquired by the French luxury conglomerates (Kering and LVMH): Gucci, Bottega Veneta and Fendi. All three cases examined show that after the acquisition sales, the distribution network and employees improved markedly. The turnover of the three brands experienced a substantial increase in 2005-2013, due to the expansion of their product offering and the global development of their distribution network. Both strategies have been sustained by the financial power and expertise of the parent conglomerates. A key driver of growth is also represented by the great ability of large groups to manage and train talents.

One of the best example of how a small brand can benefit from the integration in a large conglomerate is Bottega Veneta, that was only a small company when it joined the Kering Group (with a turnover of only €160 million in 2005) but has evolved over the years from a leather goods House into an absolute luxury Lifestyle brand, with a turnover which exceeds one billion euros and a wide range of products.

Becoming a successful luxury goods firm - especially on a global scale - requires significant resources, knowledge and experience. Consolidation – essentially through the acquisition of many smaller luxury brands by large conglomerates – is not only the way for smaller companies to survive in the consolidation jungle but also the way of being able to grow and become a global luxury brand.

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